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### The New York

# Certified Public Accountant



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Vol. XIX

March • 1949

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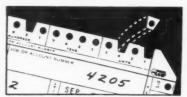
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### BOOK REVIEWS

#### Advertising Agency Financial Management and Accounting

By Ira W. Rubel. Funk & Wagnalls Company, New York, N. Y., 1948. Pages: xvii + 342; \$5.00.

A recent addition to the Printers' Ink Business Bookshelf, this compact little book is the first known full-length volume dealing exclusively with the combined financial management and accounting problems of the vast advertising agency business. The book is arranged into a text of two parts, one devoted to financial management and the second to accounting procedures, followed by an informative appendix. It contains 63 different illustrations of contracts, forms, records, accounting documents, and other significant

material.

Since both the financial management and accounting functions of advertising agencies are determined largely by the technical operations of that business, it is fitting that Part I of the book, comprising nearly 100 pages, should describe in some detail the basic nature of agencies and the various services they perform. Following a brief history of the phenomenal development of this business, this part contains separate chapters describing the major operating functions of (including newspapers, selection magazines, and radio), space buying, checking, advertising production materials, re-search, and publicity. Part I also discusses billing procedures, agency compensation, credits and collections, and budgets.

Part II discusses in some detail the various accounting procedures involved in agency operations. The emphasis here on accounting system and control is natural in view of the importance of these factors in the agency business, where efficient billing and paying are essential to the rapid turnover of working capital, which is a crucial factor in suc-

cessful operation.

A chapter on cost accounting discusses various accounting records, procedures and methods used in the preparation of cost and operating statements. The author emphasizes that the ultimate goal of these procedures is the preparation of complete operating statements designed to show the net operating profit applicable to each client. While this is unquestionably a desirable objective, not too difficult to attain in a smaller agency, it is doubtful if the extensive time records and elaborate cost allocations of indirect expenses required would warrant the preparation of such statements for all clients in a large

agency. However, the basic principles set forth in the book might be helpful guides in the development of occasional individual client statements which may be desired in

special cases.

Separate chapters of Part II disuss specific procedures and records used in the billing, paying and accounting for newspaper and magazine space, radio time, talent and production, outdoor advertising, advertising materials, and art work performed within the agency. While not specifically covered, the accounting for television time, talent and production would follow largely the pattern set for radio advertising.

Another chapter of this part sets forth specimens of the basic financial statements, a chart of accounts, and an informative summary of the accounting records, documents and procedures used in a typical agency. While the book emphasizes one specific set of procedures, they may be suggestive of others which may be more appropriate in

particular cases.

The final chapter of the basic text deals briefly with the application of punched-card accounting methods to advertising agencies. The billing, paying and accounting for newspaper space under such methods is described as an illustration, although it is pointed out that punched-card accounting methods may be used for most of the other accounting functions of sufficiently large agencies. In view of the author's extensive experience in this particular field and the increasing use of machine accounting in advertising agencies and business in general, it is somewhat regrettable that he did not devote more space to this particular subject. Perhaps this will be the basis of a subsequent book or article.

The appendix, by discussion and excerpts from official sources, describes the nature and basic purposes of the American Association of Advertising Agencies, various publishers' associations and the recognition process, credit insurance, Dun & Bradstreet reports, and the National Outdoor Advertising Bu-

and t

Written in a clear, forthright manner, this practical book should be very helpful to the newcomers and trainees in all departments of an agency, especially those having fiscal and accounting responsibilities. It should also enlighten interested outside parties, such as independent public accountants, lawyers and others not acquainted with agency operations and procedures. While not intended as a basic text for the experienced (Continued on page 151)

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(Continued from page 149)

agency executive, even he might obtain some new ideas which could improve his operations, particularly if he is a financial or accounting executive.

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### Accountants' Reports (Fourth Edition)

By William H. Bell. The Ronald Press Company, New York, N. Y., 1949. Pages: vii + 374; \$7.00.

Accountants' reports generally consist of two principal parts—the comments and the financial statements. The experienced writer of accountants' reports is well aware of the fact that the proper presentation of the comments is often a difficult part of the report. It is not an exaggeration to state that it requires years of experience to acquire the ability to write a lucid report in language which conveys to the reader what he desires to know and should know. Such proficiency might be called an art.

The author, of course, is well aware of the difficulty of becoming an efficient report writer and he has devoted a substantial portion of the book to the essentials of good reporting, in addition to the proper compila-

tion of the financial statements.

This is the fourth edition of "Accountants' Reports," and it has been brought up to date by including the latest thoughts on the subject, as reflected in recently promulgated bulletins of the Committees on Accounting Procedure and Terminology of the American

Institute of Accountants.

Of the 365 pages of text matter, 125 pages are devoted to illustrative forms of balance sheets, profit and loss statements and supporting schedules, and there are set forth common practices with respect to classification and arrangement of items The chapters include a discussion of balance sheets, income and surplus statements, consolidated and consolidating statements and such miscellaneous statements as the Cash Receipts and Disbursements Statement, Realization and Liquidation Statement, and Statement of Affairs. The contents of a complete report are also presented.

The author points out that there are variations in the form of balance sheets, and he submits his views as to the arrangement he considers the most satisfactory in the majority of cases. Some of his views will probably be challenged by other accountants, as for instance, his statement that it is unusual and, in his opinion, unnecessary to set up a reserve for cash discounts to be allowed to customers on outstanding accounts receivable.

The illustrative financial statement include those of a sole proprietor, a stock brokerage firm, a branch, an investment company, an association or institution with capital in the form of funds, a power company with items classified in accordance with the rules of a regulatory body, etc. Some published balance sheets of specific listed companies are also presented. A chapter is devoted to illustrating comments on specific subjects and another covers accountants' certificates, including some from published reports of leading accounting firms. The final chapter deals with the mechanics of report preparation and checking within the accountants' office.

The book should continue to prove helpful as a reference volume, as did its predecessors.

DAVID S. SIEGEL

New York, N. Y.

### Accounting Trends in Corporate Reports

(A study of corporate reports with closing dates in the twelve months ending June 30, 1948) by the Research Department, AMERICAN INSTITUTE OF ACCOUNTANTS, New York, N. Y., 1949. 95 pages; \$7.00.

This volume continues the long term program for the analysis of corporate reports authorized by the Council of the Institute in 1946. The first publication resulting from the study was "Accounting Survey of 525 Corporate Reports," and was issued last year.

This monograph is based on a study of over 900 annual reports, including those embraced in the previous report. To make the statistics comparable, those presented in this report are based upon the reports of the same 525 companies as were previously studied; however, material from the additional reports has been included in narrative form.

Frequent references to the pertinent Accounting Research Bulletins appear throughout the study and their influence on the current group of reports is apparent. For the most part, the procedures prescribed therein are being followed out, as is evident from the comment to the effect that only 11 auditors' reports indicated deviation from the generally accepted accounting principles embraced in Bulletin #33, on Depreciation and High Costs.

However, the report indicates that there is still room for improvement in some areas. Thus, despite the pronouncement in Bulletin #30, only 95 companies showed prepaid items in the current section, whereas 424 companies included this item in the non-current section. The fact that 89 of the 95 changed their practice this year may be indicative of a slow movement in the right direction.

The report also indicates that

"A comparison of the reported earnings (Continued on page 153)

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#### (Continued from page 151)

per share in the president's letter with the net income reported in the certified income statements, revealed that many reports quoted earnings per share based on the balance remaining after an appropriation had been deducted from a clearly designated 'net income' figure. While the amounts in the president's letter were usually clearly designated, the fact that per share figures based on 'net income' were not also quoted might prove misleading to certain readers."

Perhaps the corrective effect of Bulletin #35, issued subsequent to the reports considered in this study, will be apparent by next year.

Two reported trends are worthy of note: The study indicates a rise in the number of companies using the LIFO method of determining inventory costs from 79 to 92, during the year under review. It also notes a trend towards the use of the single-step form of income statement, although the majority of the reports examined continued to employ the multiple-step form.

This report contains a plethora of mighty useful material for those interested in the preparation and analysis of auditors' reports. It is the reviewer's hope that it will be a regular annual product of the Institute's Re-

search Department.

#### Audit Working Papers for XYZ Corporation

By C. Oliver Wellington. D. VAN NOSTRAND Co., INC., New York, N. Y., 1948. Approximately 225 pages; \$12.50.

This book presents a complete facsimile set of audit working papers, simulating those resulting from an actual professional engagement, and prepared by an outstanding authority in the field. Not only is each individual working paper an illustration of practical value, prepared in conformity with accepted auditing standards, but the entire set presents a properly unified and integrated whole.

The set is preceded by an introductory exposition of the background of the particular audit assignment upon which it has been predicated, including a discussion of the compilation of the "Permanent File" for the engagement. Also included is an excellent summary of how the reader may make the best use of the materials included in this il-

lustrative set of papers.

The preprinted audit program tabular guide sheets provide the basis for indexing, cross-referencing, and controlling the process of compiling the set of papers. They will also provide the reader with a valuable check-list of procedures. The papers also contain many special forms and letters drawn from the author's long experience. Of par-

ticular interest is the section dealing with inventories, reflecting Mr. Wellington's long experience in this area.

The work assumes a knowledge of accounting and auditing fundamentals on the part of the reader. It should be extremely useful to practitioners, teachers and students, alike. Persons engaged with the problem of training staff members will undoubtedly find their burdens considerably lightened if each neophyte is required to familiarize himself with the contents of this book.

Mr. Wellington deserves a vote of thanks from the profession for this excellent contribution to the literature on the subject of audit working papers.

EMANUEL SAXE

### Credit Management Year Book

(Volume 15)

Published by The Credit Management Division of the National Retail Dry Goods Association, New York, N. Y., 1948. Pages: 312; \$6.00 members; \$10 non-members.

The current 1948 edition of the Credit Management Year Book measures up to the high standard that has been set by the previous years' publications. This, the 15th edition of the Annual study, contains 35 chapters entirely devoted to retail credit, each full of new credit ideas, practices and procedures that successful stores have used and found profitable.

With consumer credit exceeding a total of 15 billion dollars, the increasing importance of credit in the retail field takes on added significance and the current edition of the year book is a welcome, ready reference, credit handbook and authoritative guide. It will prove invaluable to those who are interested in the field, and bring them up to date on what is new in Retail Credit. It will also help them solve their everyday problems and assist them in finding the best and most profitable method of keeping their increased credit volume on a sound basis.

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Credit Sales Promotion, which is now considered one of the most important problems of the Credit Manager for the year 1949, has been completely covered by numerous Credit Men who are considered experts in their

field.

This edition also contains the first complete analysis of Revolving Credit and anal-(Continued on page 208)

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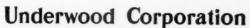
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EMANUEL SAXE, Managing Editor

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Vol. XIX

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No. 3

### Early Development of Accountancy in New York State

By THE COMMITTEE ON HISTORY

A CCOUNTANCY in New York State had its genesis long before the passage of the first C.P.A. legislation in 1896, Richard Brown of Edinburgh, in his "History of Accounting and Accountants" written in 1905, said on page 271: "The history of the profession in the United States may be said to have commenced only about twenty years ago." In 1925 James Thornley Anyon in his "Recollections of the Early Days of American Accountancy" began with: "Public Accounting in this country as a profession, I have reason to believe, had its birth some time between the years 1880 and 1883."

It is believed that Richard Brown relied upon information furnished at his request by the American Association of Public Accountants and the New York State Society of Certified Public Accountants. Mr. Anyon, who

This is the first of a series of articles on the History of Accountancy in the State of New York. It was prepared by the Society's Committee on History.

The source material for the portion hereof dealing with the founding of New York University is to be found largely in the book, "Charles Waldo Haskins, an American Pioneer in Accountancy."

came from England late in 1886 to head the New York office of his firm, Barrow, Wade, Guthrie & Co., organized in 1883, wrote from memory and quite possibly had never seen the existing records of earlier practice.

As the public practice of accountancy is directly related to business, it would seem that the date business began in this state and the establishment of the profession is of interest.

The earliest European to visit this locality was the Florentine, Verrazano, in 1524, but there is no record of any business transacted and no one of his party remained here. After an interval of 85 years, Henry Hudson, an Englishman sailing for Dutch adventurers, found this harbor and the river which bears his name in 1609. Then business began, for the records show that there were "handsome profits" from that expedition and from others which followed in 1613 and 1621. That business was largely in peltries acquired from the Indians by barter. Five vears later, in 1626, a real estate transaction was completed when Peter Minuit bought Manhattan Island from the Indians and named it New Amsterdam. Two decades later, in 1647, the colorful Peter Stuyvesant became Governor and it seems that trade had increased because in April, 1651, the Dutch Directors engaged Johannes

Dyckman as "bookkeeper in New Netherland." A year later the Directors of Amsterdam wrote that since they were "not properly informed of prizes captured, ships sold, etc.," they had sent over another man. There seems to be no record of his name so it is not possible to decide whether this second man was a public accounant or an internal auditor. Perhaps three centuries ago they did not make such a distinction.

Bookkeeping here probably started prior to 1651 but it was surely in use at that date. That there was a growing appreciation of the need for it is indicated by the newspaper announcements by those who stated that they were prepared to teach the art, some of whom also offered to open or close books of accounts.

In July and August, 1729, an anonymous advertiser stated that by inquiry at the Post Office or Coffee House: "Any merchant, or others, that wants a Bookkeeper, or their accounts started after the best methods, either in private trade or company, may hear of a Person Qualified." And teachers of bookkeeping announced themselves as follows:

George Brownell, "Merchants Accounts" and other subjects June 21, 1731.

Michael Christian Knoll, "Merchantile Accounts, Italian Fashion" 1750.

James Gilliland, "School for Merchants Accounts" 1772.

"Mercantile and Mathematic School" in Broad Street 1775.

Fifty years later, teachers of book-keeping offered their services to design systems, adjust and explain accounts, which was tantamount to the public practice of accountancy. Whether all of these earlier teachers also sought and accepted such engagements is not known but seems probable; it is doubtful, however, that these persons gave all their time to such practice.

The first *Directory of Edinburgh*, 1773, listed seven accountants; that for 1774 contained fourteen names. The first *Directory of Glasgow*, 1783, listed

six accountants; in 1790 the *British* Universal Directory contained the names of five accountants in London, and Liverpool Directory also listed five.

The first New York Directory was published here in 1786, when the population was stated by Noah Webster to be 23,614. It did not contain a classified section but three names are of interest:

"Franks, D., Conveyancer &c, 66 Broadway, Page 28.

Parker, Daniel, Auctioneer, 23 Wall St., Page 42.

Tap, William, Accountant, George St." Page 48.

Newspapers of that year carried items about these as follows:

"William Tapp has opened an office at 66 King Street for settling copartnership accounts" May 24.

"David Franks & Co. have opened a conveyancing and accountants office at No. 24 Water Street" August 1.

"Daniel Parker has opened at 16 Princess Street a scriveners and accountants office" August 7.

This first New York Directory was compiled by Franks and the other partner of David Franks & Co. was almost surely his son, Moses Franks, who had arrived in New York from Bristol only a day before, July 31, 1786.

David Franks' father was an attorney in Dublin with whom the son had served his apprenticeship and later acted for another lawyer, Counsellor Franklin. Where he had received his training in accountancy has not been ascertained. His son Moses came to America from Bristol, where he might have served an apprenticeship since Thomas Jones was then a public accountant in that city.

With only two or three exceptions New York Directories were issued annually from 1786, and in some years there were two issues by different compilers. Every issue contains names of accountants.

The 1890's witnessed the beginning of a rapid development of corporate consolidations designed to effect economies through large-scale operations. The attendant complexities of the financial and accounting problems resulting therefrom were alone sufficient to bring into existence a specialized profession competent to offer sound advice on how to deal with them. Moreover, the investment banking business, organized to provide industry with large amounts of new capital required for additions and improvements had assumed large proportions, and underwriters, as well as a growing body of investors, felt the need of having reports by independent auditors. Thus, it was no coincidence that rapid development of the profession of public accountancy began at a climactic point in the period of growth and consolidation of our economy.

While accountants in Philadelphia and Chicago also benefited from the results of "big business," New York, being the center of financial activities, attracted many accountants from Great Britain as well as from other cities in the United States. Early in 1896, the Legislature of the State of New York, at the request of certain practicing accountants of the state and for their protection, passed an act "to regulate the profession of public accountants." This act provided for a class of public accountants to be known as "certified public accountants" who were to have the exclusive right to use the designation "C.P.A." after their names; and it authorized the Regents of the University of the State of New York (State Education Department) to establish examinations and to issue certificates of recognition to those who proved themselves capable and expert and fulfilled other requisites. Prominent among those who fostered this legislation were Frank Broaker, William Sanders Davies, Henry R. M. Cook, Rodney S. Dennis, Francis Gottsberger and John Hourigan. Mr. Davies stated he worked for the bill only in New York City, but that Frank Broaker spent nearly all his time in

Albany and without Broaker's efforts the bill would not have passed in 1896.

Shortly after the passage of the act, Elijah Watt Sells made a trip to Albany to discuss certain details of the working of the new law with Dr. Melvil Dewey, Secretary of the Board of Regents. In the interview that followed, mention was made of a Board of Examiners and Mr. Sells urged that Mr. Haskins be made a member of the Board. Dr. Dewey said the matter would be decided at a meeting of the Board of Regents of the day following, when three examiners would be appointed. At this meeting, Mr. Haskins was appointed by the Regents, as were Frank Broaker and Charles Ezra Sprague, Mr. Broaker's election was doubtless a reward for his effort toward the passage of the C.P.A. law; Colonel Sprague's the result of a long standing friendship with Dr. Dewey, who knew of his scholarly attainments. At the first meeting of the Examiners, Mr. Haskins was made President. The first examination under the new law was held in December 15-16, 1896. In the year 1896-97, one hundred and twelve certificates were awarded, one hundred and eight under waiver and four the result of passing examinations.

On March 30, 1897, the New York State Society of Certified Public Accountants was organized and Mr. Haskins became its first president. The first annual meeting was held May 10, 1897. About this time, there came suggestions for the founding of a school of accounting. The Board of Regents felt the need of it; the New York State Society discussed it freely; Mr. Haskins made many plans for transforming the idea of a school into a living actuality; and other members of the profession were in close sympathy with the movement.

At the November, 1899, meeting of the State Society, Henry R. M. Cook introduced a motion requesting the President to confer with the Trustees of New York University for the purpose of arranging for the establishment of a technical course of study in the science of accounts, finance, economics, business practice, commercial law, etc. In December, 1899, Mr. Haskins, President of the Society, wrote to Chancellor Henry M. MacCracken, requesting a conference for the purpose of establishing the desired technical course of study.

The story of one part of the struggle for an educational institution of accountancy can best be told by quoting Mr. Haskins\*:

"A history of the origin of this school would be the history of accountancy, especially in America, and of the movement in behalf of higher commercial education whose wave is now washing the shores of the United States. Most of you are fa-miliar with the laws regulating the profession of accountancy, and with the efforts of the better class of accountants to secure a solid educational and social basis for the profession, as well as with the rise and growth of what is coming to be known as the profession of administration-represented by men of marked executive ability, whose bent of mind is toward the comprehensive and detailed control of affairs. From these sources has come the two-fold demand which has been recognized by the New York University in the establishment of the new school. The more immediate story, however, of its origin is too good to be lost.

"Chancellor MacCracken, in his last annual report, reminded the Council that the seventieth anniversary of the University would occur in October, 1900, and suggested the celebration of this septuagesimal in some way which might at the same time signalize the advent of the twentieth century of our era. Consciously or unconsciously, this suggestion was a preintimation of the establishment of the eighth teaching institution under the University. Shortly after the appearance of the Chancellor's report, a committee representing a large number of leading professional ac-countants of the State of New York laid before him an outline of a plan for a school or college of accountancy, emphasizing also the desirability of University control of such a school, with a view to placing the profession upon a proper educational and moral basis of efficiency and reliability.

"The matter was presented to the Council of the University, and was duly con-

sidered by a special committee, consisting of Dr. MacCracken, Messrs. William F. Havemeyer, William S. Opdyke, William M. Kingsley and James G. Cannon. Consultation led to further suggestion; the movement for higher commercial education received due consideration; to accountancy was added commerce, and to these finance; the practical every-day applications of the broad science of economics were canvassed as only men of large economic thought and experience are able to cope with the subject; and on July 28 the petitioners were officially notified of the decision legalizing the foundation of the new college, to be known as the New York University School of Commerce, Accounts and Finance.

"Thus in the morning watch of the dawning century, comes into existence an institution of professional learning fitly characteristic of the age and memorial of an epoch in the life of a great administrative corporation."

On October 1, 1900, the new school—the first of its kind in the world—began its pioneer work in the University building in Washington Square, New York. Speeches were delivered by Chancellor MacCracken, Colonel Sprague, and other members of the faculty. The Dean of the School, Mr. Haskins, after a few general remarks, gave his first lecture as Professor of the History of Accountancy. There were about fifty matriculants in attendance at this opening session.

What may be termed the intellectual and ethical platform of the School can be expressed in Mr. Haskins' own words:

"No attempt will be made in the school to foster the notion that commerce or accountancy is a royal road to wealth, or to leisure, or to unmerited social position; but in addition to the intellectual qualifications of talent for observation, power of perception, patience of investigation, presence of mind, judgment, reflection, order and method, aptitude for calculation, abstraction, memory, mental activity and steadiness, which it is hoped the student will possess in some fair degree, the moral virtues of honesty, candor, firmness, prudence, truth, justice, economy, temperance, liberality, politeness, good temper, self control and

<sup>\*</sup> From a biographical sketch by William G. Jordan in "Charles Waldo Haskins-An American Pioneer in Accountancy," Prentice-Hall, Inc., New York; Copyright, 1923, by Haskins and Sells; pages 65-66.

perseverance will be inculcated as necessary to his own personal welfare and the stability of the business world." \*

The first professors and instructors, who were nearly all certified public accountants, gave their time and abilities almost gratis and at a real personal sacrifice. It was with them largely a labor of love and a fine spirit of devotion and helpfulness to their profession. The sessions of the School, contrary to all accepted traditions, were held in the late afternoons and in the evenings. The majority of the students were employed for the greater part of the day in some line of business activity.

Despite all the hardships, struggles, discouragements, and obstacles, the new venture conquered and flourished and within a few years this, the youngest School in the University, had the largest enrollment of students. It not only performed fine, loyal, direct service to the profession in the number of young men it trained to take their places with splendid equipment and high ideals in the ranks of certified public accountants, but the School itself became an exemplar and an inspiration to other schools, more or less similar, started in other parts of the country.

Some of the early struggles are set forth by Leon Brummer, who had been a devoted ally in the movement to get the School organized, and was a teacher in the beginning:

"The students were permitted to enter certain classes of the Law School, and other than the teachers of those Law School classes, there were but six teachers of accountancy, one teacher of economics, and one other instructor. I know that, judging from my own class, the accounting knowledge of the students was so ungraded: the knowledge of the teacher and his ability to teach was so uncertain; and the confidence of the scholars, who were continually asking for instruction in higher accountancy, was so wanting, that nothing but the persistent efforts and the personal encouragement and glorious example of

Charles Waldo Haskins kept the school from following in the footpaths of those schools which had gone before. As I look upon this scene and upon the inexperience of the early teachers, the absolute absence of guiding precedents, the want of literature, the eagerness of all those students of more than average intelligence for instruction in accounting, it is not at all surprising that the older and unschooled accountants of today fear to undertake the duties of a teacher in this school, but leave this task mostly for the men who have been graduated from the school."†

Another outstanding pioneer for the right kind of education, if the profession were to occupy that position in economic life to which it was entitled, was Charles Ezra Sprague. Then president of the Union Dime Savings Bank, he became a member of the faculty of New York University, teaching classes at night until his death. His teachings were of subjects for which there were no texts or allied readings; it was new in every respect, demanding the devising of methods and preparation of materials, both of which consumed untold hours outside the classroom.

The late Joseph French Johnson, when dean of the School, described Colonel Sprague's connection with it in a part of the introductory material of the fifth edition of the Colonel's *Philosophy of Accounts:* 

"Very few realize what an important part Colonel Sprague played in the organization and development of the School of Commerce, Accounts and Finance of New York University. \* \* \* He realized the necessity of the right kind of education if the profession was to occupy that position in economic life to which it was entitled. When the New York State Society of Certified Public Accountants appointed a committee to consider the question of professional education, Colonel Sprague made himself an unofficial member of that committee. Their labors resulted in a report presented to the Society in December, 1900, in which the members of the Society were advised that New York University had agreed to establish a school for the purpose of training men for business. The

<sup>\*</sup> Ibid., page 68.

<sup>† &</sup>quot;The Inception and Foundation of the School of Commerce, Accounts and Finance," by Leon Brummer. The Journal of Accountancy, Vol. XI, No. 4, February, 1911; pages 254-255. (Reprinted in "Charles Waldo Haskins," supra, pages 68-69.)

progress made in twenty years is strikingly shown by comparing the curriculum of today with the outline of courses incorpo-

rated in that report.

"University administrators are conservative by nature and the organization of a frankly professional school of business was an innovation. Not only was it looked at askance within the University itself, but the so-called practical men of business as well as administrators of other colleges opposed the movement. It was not to be expected that Chancellor MacCracken of New York University would view the matter differently from most college presidents. He was a man of vision and the process of conversion was more easily undertaken on that account, but he knew that the proposed school would have no endowment and he clearly saw that he could not safely add to the financial burdens under which his institution was laboring.

"When things appeared darkest and when it seemed as though the project was likely to fail, Colonel Sprague decided to adopt unusual measures as an unofficial committee of one. He rented the house of one of the University professors for the summer vacation. In this way he was bound to meet the Chancellor on the campus, and during frequent walks together, they discussed the project that was nearest to the Colonel's heart. We cannot measure the extent of the influence which Colonel Sprague brought to bear upon Chancellor MacCracken through this unusual step. He made his own opportunity; the method was novel; the Colonel's quiet and modest manner was effective and he communicated something of his own conviction to the Chancellor. Although no endowment was provided, the Chancellor was assured that no deficit would result. Whatever may have been the effect, we know that the Chancellor finally gave his approval. The Colonel was a member of the original faculty and served the University until his death.

"Colonel Sprague was the first member of the faculty of New York University School of Commerce whom I heard speak from a lecture platform. It was in the winter of 1900-1901. I was then connected with the University of Pennsylvania and was spending a few days in New York in attendance on some convention. I had heard of New York University's new School of Commerce and, under the escort of Dean Charles Waldo Haskins, two of my colleagues and I paid it a visit. Colonel Sprague was lecturing on the philosophy of accounts to a class of forty men ranging in age from twenty to fifty who knew

little about accountancy, but I was greatly impressed by the clearness of the lecturer's ideas, by the grace of his manner of speech, and by his most courteous responses to the questions asked now and then by some of the students. I remember that I was somewhat surprised when I was told after the lecture that Sprague was not by profession a teacher or writer, but was president of a savings bank and lectured without compensation because he loved his subject and had great faith in the future of the new school.

"His students all loved him. On the platform he was intensely in earnest, always serious. I never heard of any student willingly cutting one of his lectures. He usually came to his lecture room in evening dress. If any of his colleagues had done the same there would have been comment and undoubtedly some chuckles among the students, but there was an instinctive feeling that Colonel Sprague came in full dress, not because of pride of appearance, but because he had a deep respect for his evening's task and wanted to do it as nearly right as possible. He was a most modest man, unassuming and without pretense

of any sort.

'After I came to the School in 1901 I had many delightful talks with Colonel Sprague in my office before and after his lectures. We never talked about accountancy, perhaps because he knew that I didn't know much about it. He liked to talk about the books that both of us had read, and about our college days and studies, and about what had to be done to make accounting a real profession. I remember being greatly impressed by his enthusiastic devotion to the welfare of his Alma Mater and by his almost boyish love of his old college fraternity. In fact, Colonel Sprague was one of the most human men I have ever met."\*

Limitation of space precludes narrating in detail the splendid efforts of other pioneers in furthering the profession among whom were: Arthur W. Teele, Farquhar J. MacRae, F. W. Lafrentz, John R. Loomis, Anson O. Kittredge, Leonard H. Conant, John R. Sparrow, Theodore Koehler.

The late eminent jurist, Oliver Wendell Holmes, Jr., speaking of the legal

profession said:

"However much we may codify the law into a series of seemingly self-sufficient propositions, those propositions will be but a phase in a continuous growth. To un-(Continued on page 176)

<sup>\*</sup>From Dean Johnson's Introduction (pages v-vii) to "The Philosophy of Accounts," (Fifth Edition) by Charles E. Sprague; The Ronald Press Company, New York, 1923.

### The Corporation Franchise Tax Under Article 9-A

By EMERY W. BURTON

It has been quite some time since I last appeared before your group to talk about franchise taxes. When your chairman asked me to talk to you tonight, I inquired as to the subject he wished to have me cover, and we agreed that you probably would be principally interested in franchise taxes collected under Article 9-A.

We believe that we have a good law which is more flexible than the provisions of old Article 9-A, and that it is generally working out very satisfactorily. It has been accepted almost without reservation by the taxpayers as an important forward step toward greater equity and tax justice. Our studies have shown that while there have been some individual fluctuations in tax downward and upward, the over-all effect on State revenues has been small and the individual fluctuations have been substantially justified

EMERY W. BURTON entered State service in 1909, and became affiliated with the Corporation Tax Bureau of the State Comptroller's Office in 1911. He remained in that Bureau when its activities were transferred to the State Tax Department. In 1939, he was appointed Deputy Director and, in 1943, he became Corporation Tax Director and Deputy Tax Commissioner.

Commissioner Burton served in the New York National Guard from 1913 until 1940, and attained the rank of Captain. He was on active duty on the Mexican Border during 1916, and served overseas in World War I from 1917 until 1919.

This address was delivered by him before the Albany Chapter of the Society, at a meeting held on December 14, 1948, at the Wellington Hotel. on the ground of fair treatment and tax equity.

Shortly after Governor Dewey took office there was a Committee appointed to review the provisions of Article 9-A, and to determine whether or not it needed revision. This Committee was compesed not only of representatives of the Tax Department, but it also included a number of accountants and lawyers representing taxpayers. After considerable study, recommendation was made to the Governor for the complete revision of Article 9-A and, based upon such recommendations, the Legislature enacted the new law, which was signed by the Governor in March of 1944. Some amendments have been made since that time, but no great changes have taken place.

The Committee found that the law should be made more flexible so that proper treatment could be accorded each corporation, depending on the type of its activities. It was also found that the method of allocation employed under old Article 9-A did not produce the proper result.

Under old Article 9-A business, investment and subsidiary income and capital were treated as one and were allocated by one allocation percentage. If the taxpayer had no regular place of business outside of New York, a tax was computed on 100% of the income from all sources. This meant that if a corporation was partly a business corporation and partly an investment trust or a holding company, that all of its income was allocated in the same manner as business income.

Under the provisions of the new law each class of income is treated differently. Business income is treated as such and allocated by a business allocation percentage. Investment income, as defined by the statute, is allocated by an investment allocation percentage and every corporation is entitled to allocate investment income even though it has no regular place of business outside the State of New York. 50% of dividends received from other than subsidiary corporations is exempt. All income from subsidiary capital is also exempt.

The starting point for determining State taxable income is the entire net income reported to the United States Treasury Department. Our tax form is devised, for the convenience of the tax-payer, so that most of the information with relation to gross income and deductions can be copied from the first page of the Federal report.

Entire net income for State purposes, however, is not exactly the same as Federal net income,

Income from subsidiary capital, included in Federal net, is exempt and

is deductible.

50% of all dividends from corporations, not classed as subsidiaries, is also deductible. After allowing these deductions we add to Federal net income all interest income from State and Municipal bonds and certain obligations of the United States and its instrumentalities, which was not included in Federal net; also, net operating losses of other years, which were deducted in computing Federal net income.

We also add 90% of interest on indebtedness to any stockholder or shareholder (including subsidiaries of a corporate stockholder or shareholder), or members of the immediate family of an individual stockholder or shareholder, owning in the aggregate in excess of 5% of the issued capital stock of the taxpaver, except that such interest may be deducted up to an amount not exceeding \$1,000, and may be deducted in full to the extent that it relates to bonds or other evidences of indebtedness issued, with stock, pursuant to a bona fide plan of reorganization, to persons, who, prior to such reorganization, were bona fide creditors of the corporation or its predecessors, but were not stockholders or shareholders thereof. Such interest is also deductible in full where the investment allocation percentage is applied to entire net income.

In addition, there is added to Federal net income any deduction claimed which was directly attributable to subsidiary capital. This is so because income from subsidiary capital is exempt.

After Federal net income has been so adjusted, we then exclude the New York State Franchise tax which was deducted in determining Federal net income and allow as a deduction such taxes based on the year or period immediately preceding the year or period covered by the report.

After "entire net income" as defined by the statute has been determined, we then separate such income into Business income and Investment income. Business income is allocated by a business allocation percentage, and Investment income by an investment allocation percentage.

Business income is allocable 100% to New York unless the taxpayer can show that it has a regular place of business outside New York. If it has a regular place of business outside New York, then Business income is allocated by the so-called "Massachusetts formula", which is used in a number of other states. It is a three factor formula using property, receipts and payrolls. The percentage of each factor is determined and the total of the three percentages, so determined, is divided by three to find the business allocation percentage to be applied to business income.

Investment income is allocated on the basis of the amount of capital employed in New York by each corporation whose securities are owned by the taxpayer. The dollar value of all such securities, allocable to New York, is added together and divided by total investment capital and the resulting percentage is applied to taxable investment income to determine the portion of such income to be included in the taxable base.

As I have said before, the business allocation formula contains three factors:

Property Receipts Payroll

There is very little difficulty in determining the property factor. It includes all property owned by the taxpayer and, of course, is allocable to the place where the property is located. Property owned by others, even though it is used in the business of a taxpayer,

should not be included.

At this point it might be well to tell you that we attempted to amend the law, at the last session of the Legislature, to provide for the inclusion in the property factor of real property rented to the taxpayer, in addition to real property owned by the taxpayer. One of the compelling reasons for our action was because a number of corporations were selling their plants to insurance companies and others and then leasing them back on a long-term lease. This, of course, under the present statute, eliminates the value of such property from the property factor and seriously affects the property factor percentage. This is not a one-way street. If the property was located outside New York, the allocation percentage attributable to New York is increased. If such property is located in New York, the New York allocation percentage is decreased. In both of such cases the business is carried on in the same manner as before the sale, and we believe that such a transaction should not have the effect of increasing or decreasing the allocation percentage. We, however, were not successful in having this amendment adopted by the Legislature. We believe that the amendment is sound and will, no doubt, try again at the next legislative session.

The only controversial side of this factor is, what is the fair market value of the property? Book value, in some cases, may be the fair market value, but in many cases book value does not represent fair market value. For in-

stance, a corporation may carry certain assets on its books for \$1.00 or some nominal amount. In such cases the fair market value of those assets should be inserted in column (d) of Schedule C of the report. It should also be kept in mind that the same method of valuation which is used in determining the amount of the tax-payer's capital must be used in determining the percentage in the property factor, and the same method of valuation must be used consistently with respect to property within and without the State.

Property, while in transit from a point outside New York to a point in New York or vice versa, does not have a fixed situs either within or without the State and, therefore, should not be included in either the numerator or denominator of the property factor. Property in transit from a point in New York to another point in New York is situated or located in New York and should be included in both the numerator and the denominator. Property in transit from a point ouside New York State to another point outside New York State is also to be included in the denominator but not in the numerator.

A ruling has been issued by the Commission under the equitable powers granted to it by the statute, which affects the property factor. This ruling . provides that where a taxpayer is entitled to an allocation of its business income and capital, and both within and without New York it owns no real property, and its ownership of tangible personal property, both within and without New York, is comprised solely of furniture and fixtures and other office equipment, it may make application to the Commission for the elimination of the property factor and the substitution, as a third factor, of business expenses (other than salaries and wages). Such expenses include only expenses used in the calculation of the taxpayer's entire net income incurred or expended in service, operation and maintenance of a nature as may be allocated within

and without the State, such as rent, office supplies, traveling and entertainment, postage or communication, trucking, shipping or delivery, local property taxes, income excise or franchise taxes, other than Federal, license fees and general or miscellaneous expense. These items are not necessarily exclusive, but are indicative of the character of business expenses that may be used in determining the substitute percentage. This ruling will permit realistic treatment of certain corporations where the application of the regular formula would have produced a distorted tax result.

Likewise, there should be very little difficulty in determining the payroll factor. All wages, salaries and other compensation paid to employees of the taxpaver should be included, with the exception of such amounts paid to general executive officers. The portion to be allocated to New York must include all wages, salaries and other compensation paid to employees regularly connected with or working out of an office or place of business maintained by the taxpayer within New York. However, if the taxpayer can establish to the satisfaction of the Commission that, because of the fact that a substantial part of its payroll was paid to employees attached to a New York office who performed a substantial part of their services outside New York and that the computation of the payroll factor according to the general rule would not produce an equitable result, the Commission may, in its discretion, permit the payroll factor to be computed on the basis of the amount of compensation paid for services actually rendered within and without the State.

When we come to the Receipts factor there is more chance for a difference of opinion as to what receipts are properly allocable to New York. One thing, however, that there can be no question about is that all receipts from the sale of the taxpayer's goods shipped to a customer from New York are allocable to New York without regard to where the order was received or accepted.

Receipts from the sale of the taxpayer's goods are allocable to New York if such property was not located, at the time of receipt or appropriation to the orders, at any permanent or continuous place of business maintained by the taxpayer outside New York, provided the orders are either received or accepted in New York.

We had a little difficulty in administering this feature of the law, particularly where goods located in public warehouses outside New York were sold by agents or brokers, not regular employees of the taxpayer, where the taxpayer had delegated authority to such persons to receive and accept the order and make delivery from the public warehouse. We have always contended that such receipts were allocable to New York, and to clarify our position we recommended to the last Legislature an amendment to the statute which was adopted and is effective with respect to returns due on or after May 15, 1949. The amendment was made to Section 210 and provides that an order shall be deemed received or accepted within New York State if it has been received or accepted by an employee, agent, agency or independent contractor chiefly situated at, connected with by contract or otherwise, or sent out from a permanent or continuous place of business of the taxpayer within the State of New York. We are quite sure that this will clear up any doubts as to the proper allocation of receipts in such cases.

In all cases where a taxpayer fills an order from a stock of goods located at a permanent and continuous place of business maintained by such taxpayer outside New York State, the receipt is properly allocable outside New York even though the order was received or accepted in New York.

Receipts from services performed within New York are allocable to New York. It is immaterial where such amounts were payable or where they actually were received. If the tax-payer's services, for which commissions

were received, were performed for the corporation by salesmen attached to or working out of a New York office of the taxpayer, the taxpayer's services are deemed to have been performed in New York.

Receipts from rental of real and personal property, situated in New York, are allocable to New York.

Royalties from the use, in New York, of patents or copyrights are allocable to New York.

All other business receipts earned by the taxpayer within New York are allocable to New York. However, such receipts are not considered to have been earned in New York solely by reason of the fact that they are payable in New York or actually are received in New York.

The State of New York does not permit the computation of the Franchise tax by a separate accounting method. There are many reasons why we believe that the allocation basis produces the proper result. Time does not permit of a lengthy discussion of such reasons. One of the difficulties, however, which would be encountered would be the allocation of general overhead expense and advertising. I have been informed recently that many of the states in which separate accounting was allowed are discontinuing this practice.

Some taxpayers do not recognize the distinction in the law and regulations between a "regular" and a "permanent and continuous place of business". This distinction is very important, particularly with respect to the allocation of receipts. For example, let us take the case where a taxpaver has merchandise regularly located outside of New York State in a public warehouse from which deliveries are made to its customers. It has no other place of business outside New York. In such a case the department recognizes that this is a "regular" place of business and it, therefore, will permit such a taxpayer to allocate this property outside New York. However, the warehouse is not

regularly maintained by the taxpayer by its employees and, therefore, it cannot be considered as a "permanent and continuous place of business" of such taxpayer. You might say "well why is that important"? It is important because the question of allocation of receipts is involved. In such case the receipts arising from the sale of the property in the warehouse are properly allocable to New York.

There seems to be no question but that the new business allocation formula represents a decided improvement over the old, primarily because it eliminates property as the main control and uses three factors with equal weight. A study made by the department of many cases appears to indicate clearly that the new allocation formula, employing an average of three percentages, does not create as many wide variations between individual companies as the old formula based solely on average monthly dollar values. We do not claim perfection for the new law. That was not claimed when it first became effective. We are continuing our studies of its practical effect and shall continue to improve its structure as opportunity for improvement develops.

The present rate of tax for Business and Investment income is  $4\frac{1}{2}\%$ . This is a reduction of 25% from the old 6% rate.

In addition to the tax measured by Business and Investment income, there is a Subsidiary Capital tax. This tax is computed at the rate of one-half mill for each dollar of the first fifty million dollars of subsidiary capital allocable to New York, one-quarter mill for each dollar of the next fifty million dollars so allocated and one-eighth mill for each dollar over one hundred million dollars allocable to New York. This is a very low rate and has attracted many holding corporations with substantial subsidiary capital to New York State.

Of course, we hope that all of the corporations which you gentlemen represent will continue to earn substantial profits and continue to pay New York Franchcise taxes measured by net income. However, if at any time this does not occur, you will be required to pay a New York Franchise tax measured by total Business and Investment Capital, at the rate of one mill, in addition to the Subsidiary Capital tax.

The amount of Business Capital is determined by taking the average fair market value of the gross business assets less average liabilities payable by their terms on demand or within one year from the date incurred. The amount of Business Capital allocable to New York is computed by multiplying Business Capital by the Business allocation percentage.

Investment Capital is defined to mean investments in stocks, bonds and other securities, corporate and governmental, not held for sale to customers in the regular course of business, exclusive of

subsidiary capital.

The amount of Investment Capital is determined by taking the average fair market value of the gross assets representing Investment Capital less, in the discretion of the Tax Commission, any liabilities payable by their terms on demand or within one year from the date incurred which are attributable to Investment Capital. The portion of such capital allocable to New York is found by multiplying the amount invested in each stock, bond or other security (other than governmental securities) held during the period covered by the report, by the percentage, if any, of the entire capital or the issued capital stock or the net income, as the case may be, of the issuer or obligor thereof required to be allocated within New York State on the report required of any such issuer or obligor under the New York Tax Law for the preceding year, without regard to any minimum.

However, the statute provides that the Investment Capital percentage may not be less than 15% unless the taxpayer establishes to the satisfaction of the Tax Commission that less than 15% of the Investment Capital is employed, and less than 15% of its In-

vestment activities are conducted within New York State. The portions of Business and Investment Capital allocable to New York are added together and the one mill rate applies.

You gentlemen are the ones we most generally come in contact with, with respect to your corporations' tax matters and, therefore, it might be well, at this point, to say just a few words concerning the filing of reports generally. You can be of enormous help to us in our job of administration if you will see to it that proper and complete Franchise Tax returns are filed with the department. When a report is audited. difficulties immediately arise where the taxpayer has failed to answer some of the questions on the form. Inevitably, this leads to time-consuming correspondence, which might have been avoided. Generally, the taxpayer's reply to a letter is "That item was left blank because there was nothing to insert". If you would simply indicate "No" or "None" in these spaces, rather than to leave them blank, we would save a great deal of time and expense and you would be saved the annovance of further correspondence, and in most cases the necessity of filing affidavits correcting the report. I cannot emphasize too strongly the necessity for completing all of the forms furnished by the department. Don't attach separate schedules as a substitute for answers required on the form. Separate schedules are acceptable only where necessary to amplify the answers to questions on the form.

A word concerning the general policy of the Commission on the application of equitable adjustment provisions in the law may be timely. You know, of course, that under the law, these provisions cannot be exercised without the issuance of a published ruling. It is the general policy of the commission to exercise these provisions only in rare instances where their use is fully justified and warranted by the facts. It must be remembered that it was never the intent of the Legislature to bestow up-

on the Commission legislative powers or to permit the Commission to institute basic changes by administrative ruling.

You may be interested to know whether New Article 9-A has been instrumental in bringing new business to New York State. There appears to be no question about it. The new law, coupled with the 25% reduction in the tax rate has served as strong inducement to business to come to New York and stay there. Since the enactment of the new law, 3,120 foreign corporations have obtained certificates of authority to do business here and 965 foreign corporations became taxpayers, although they did not obtain certificates of authority because of conflict of names. In addition, 37,609 corporations were organized in 1946 alone, under the laws of this State. Of that number approximately 30,000 were corporations which will report under Article 9-A. Most of the others were real estate corporations taxable under Section 182 of Article 9. This is an increase over the previous vear of 21,003. In 1947, 26,240 corporations were incorporated under the laws of New York State and so far this year there have been 15,966 new corporations formed. Of course, we do not claim that New 9-A is responsible for all of this increase.

Of the many new foreign corporations, which have moved into New York State because of more favorable conditions, there are a large number of holding companies which formerly avoided New York and New York tax liability. Many holding companies may find it to their advantage to look into the provisions of new 9-A. The exemption of income from Subsidiary Capital and the low rate of tax on Subsidiary Capital along with the many advantages of being in New York State should be considered. A number of manufacturing companies have also been encouraged to locate in the State because of the assurance of fair tax treatment.

It would not, of course, be fair of me to leave you with the impression that

we have no problems in the administration of this tax.

One of the problems involves the wage factor in cases where the principal office of the corporation is located in New York, but where only a small percentage of its general activities are carried on in the State. In such cases the taxpaver has claimed that the wage factor percentage has the effect of allocating to New York a greater portion of the income than should be so allocated. They claim that because the general office is in New York, the wage factor is inflated by wages paid to emplovees located in New York, whose activities are in whole or in part connected with activities of the taxpayer outside of New York, and they have asked that the wages paid to such emplovees be eliminated from the wages allocable to New York. The Commission has taken the position that it cannot exercise the equitable powers in such a case because the Legislature, in adopting New 9-A, gave serious consideration to the wage factor and eliminated therefrom salaries paid to general executive officers, and that if it had seen fit to eliminate any other salaries or wages it would have done so. If the Commission, by ruling, permitted any further elimination it would be usurping the powers of the Legislature. If any relief is to be granted in such cases, it must be accomplished by legislative amendment. We haven't as vet found the answer. I might mention in passing, however, that in all of the cases we have had of this kind we have found that the taxpayer in reporting to other states has had the benefit of the wages paid in New York in computing the allocation percentage used to measure the taxes pavable to such states.

At any time that you wish to come in to discuss the tax problems of your corporation we will make every effort, within reason, to arrange the time for such a conference to suit your convenience. We cannot always give you what you want, but at least we can say

"no" with a smile.

# Depreciation of Buildings Held in Testamentary Trusts

By THEODORE PROPP

When property held in a testamentary trust includes incomeproducing buildings, and the will contains no express directions, should depreciation expense be charged to the income beneficiary? Accountants now

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universally agree that the proper computation of net income involves a charge for depreciation. It is not to be assumed, however, that depreciation is always a proper expense in the computation of trust income.3 While ordinary financial statements are designed to furnish information for gauging the prosperity and prospects of an enterprise, fiduciary accountings are essentially reports of stewardship, designed to show whether the trustee has properly performed his fiduciary duties.4 Because of this difference in purpose, "generally accepted accounting principles" are not conclusive in fiduciary accounting;5 instead we must look to decisions of courts for the answer to our problem. Three solutions are possible:

- (1) The trustee must charge income with depreciation.
- (2) The trustee may not charge income with depreciation.
- (3) It is a matter as to which the trustee has discretion.

<sup>1</sup> It is assumed that the buildings are original trust assets which the trustee has authority to retain. See N. Y. Decedent Estate Law, § 111(6).

<sup>2</sup> The New York cases indicate no distinction as to whether the buildings are original or subsequently-acquired trust assets, although in other states this distinction is often vital in the determination of income from wasting assets. See 2 Scott, Trusts § 239.3. But see Restatement, Trusts § 239, comments c and d (1935). Subsequently-acquired buildings are akin to amortizable improvements, since they represent a diversion of trust assets which would disproportionately increase productivity at the expense of remaindermen if no amortization were charged. It would seem therefore that depreciation of such buildings should be charged to income. Such a holding is left open by the New York decisions, all of which have concerned original trust assets. But see Matter of Schummers, 210 App. Div. 296, 301 (4th Dept., 1924), affd., 243 N. Y. 548 (1926) (dictum apparently limiting propriety of depreciation charge to "improvements," where original trust building was destroyed by fire, rebuilt, improved, appropriated by the State, repurchased and further improved). But cf. Matter of Crimmins, 159 Misc. 490 (Surr. Ct., 1936).

<sup>3</sup> It should be noted that the income beneficiary is entitled to a deduction for depreciation in computing his federal income tax, although no such deduction entered into the computation of distributable trust income. Int. Rev. Code § 23(L): Commissioner v. Gutman, 143 F. 2d 201 (2d Cir., 1944); McV cigh v. Commissioner, 3 T. C. 1246, 1259 (1944).

<sup>4</sup> See Dodge and Sullivan, Estate Administration and Accounting 553 (1940); Saxe, Estate Accounting 82-83 (1939).

<sup>5</sup> For a discussion of how this affects the wording of the accountant's report, see Traver, How Depreciation Affects Distributions of Income from Property Held by Trustee, 85 J. Accountancy 320 (1948).

In almost all New York cases in which the question has arisen, the courts have taken the second view.6 Recently, however, this "general rule" has been criticized in judicial opinions,7 in learned treatises,8 and in accounting and legal periodicals.9 The recent Werbelovsky10 case went so far as to suggest that the principles stated in cases enunciating the "general rule" should not be ". . . extended in their application beyond the factual situations existing in the particular case."

The present uncertain state of New York law on this question exposes trustees to possible liability. Relying on the "general rule," they will probably continue to ignore depreciation in the computation of distributable income. Should it later be held that a charge for depreciation is mandatory, they could be surcharged for excessive payments to income beneficiaries. Of course, it may be possible for a trustee to get instructions from the surrogate,11 but this is both expensive and timeconsuming. What is needed is a clear statement of the law which will furnish a reliable guide for trustees as well as do justice between income beneficiaries and remaindermen.

### Inferring the Testator's Actual Intent

The construction of a will involves primarily a search for the testator's intent, which will be given effect unless it contravenes public policy. The "general rule" is sometimes stated as holding that the testator is conclusively presumed not to have intended a depreciation charge against the income beneficiary in the absence of express provision in the will.12 A close study of the cases, however, indicates that this is an overstatement, for the New York courts have sometimes considered evidence of actual intent as relevant.13 Apparently they would permit a depreciation charge against the income beneficiary where the testator's intent, though not explicit, could be inferred with reasonable certainty.

Rather than attempt to generalize, it is more profitable to consider some specific situations which should supply adequate evidence of the testator's intent:

(1) Where the trustee has been given discretion to determine what is income and what is principal, it seems

13 See, e.g., Matter of Edgar, 157 Misc. 10, 11 (Surr. Ct., 1935).

<sup>6</sup> Matter of Wadsworth, 81 N. Y. S.2d 298 (Surr. Ct., 1948); Matter of Danziger, 58 N. Y. S.2d 790 (Surr. Ct., 1945), modified on other grounds, 271 App. Div. 888 (2d Dept., 1946); Matter of Horowitz, 111 N. Y. L. J. 2393 (Surr. Ct., June 21, 1944); Matter of Adler, 164 Misc. 544 (Surr. Ct., 1937); Matter of Edgar, 157 Misc. 10 (Surr. Ct., 1935); Smith v. Keteltas, 62 App. Div. 174 (1st Dept., 1901); accord, Matter of Chapman, 32 Misc. 187 (Surr. Ct., 1900), affd., 59 App. Div. 624 (3d Dept., 1901), affd., 167 N. Y. 619 (1901) (depreciation of steamboat not chargeable to life beneficiaries); Chisholm v. United States, 19 E. Surg. 274 (Ct. Ct.) 1932) (applying New York law); see Matter of Hillingt 164 Misc. (depreciation of steamboat not chargeable to life beneficiaries); Chishoim V. United States, 19 F. Supp. 274 (Ct. Cl., 1937) (applying New York law); see Matter of Hilliard, 164 Miss. 677, 691 (1937), affd., 254 App. Div. 879 (2d Dept., 1938); cf. Matter of Crimmins, 159 Misc. 499 (Surr. Ct. 1936). But see Matter of Werbelovsky, 119 N. Y. L. J. 981 (Surr. Ct., March 16, 1948). But cf. Stevens v. Melcher, 152 N. Y. 551 (1897).

7 Matter of Werbelovsky, supra note 6; Matter of Horowitz, supra note 6.

8 See 2 Scott, Trusts § 239.4 (1939); Dodge and Sullivan, Estate Administration and

Accounting 447 (1940).

<sup>9</sup> See Hartwig, Should the Accountant Depreciate Investment Buildings Held By Trustees Under Testamentary Trusts?, 18 U. of Chi. Journal of Business 41 (1945); Traver, supra note 5; Note, 60 Harv. L. Rev. 952 (1947).
10 119 N. Y. L. J. 981 (Surr. Ct., March 16, 1948).
11 N. Y. Surr. Ct. Act § 145.
12 See, e.g., Chisholm v. United States, supra note 6 (applying New York law). There

is a possibility that an express direction charging income with depreciation would be violative of statutes forbidding accumulations of income. N. Y. Pers. Prop. Law § 16, N. Y. Real Prop. Law § 61; see 47 Yale L. J. 1026, 1030 (1938); 29 Mich. L. Rev. 351 (1931). Although the precise question does not appear to have been decided in New York, analagous cases suggest that this would not constitute an unlawful accumulation. Cf. Matter of Nesmith, 140 N. Y. 609 (1894); Equitable Trust Co. v. Prentice, 250 N. Y. 1 (1928).

clear that his discretion embraces the problem of depreciation.<sup>14</sup>

(2) A direction that the trustee replace a worn-out building justifies the inference that this is to be accomplished by a funded depreciation reserve built up by periodic charges to income, at least where the building constitutes the major trust asset.<sup>15</sup>

(3) If the property is included among the assets of a business which is run by the trustee, it is reasonable to infer that the testator contemplated the inclusion of depreciation as an ordinary expense of doing business.<sup>16</sup>

(4) Where the testator has created a trust of buildings with the income to a charity forever—to provide scholarships, for example—we may infer that the testator contemplated the preservation of corpus by depreciation charges to income.<sup>17</sup> Otherwise the scholarship fund would last no longer than the buildings.

(5) The testator's intent may be manifest from an examination of evidence showing how he planned his will. For example, if income statements for the buildings included depreciation among the expenses, and if it can be shown that the testator relied on the "net income" figure as an indication of what the income beneficiary would receive under the trust, we may safely infer an intent that the trustee is to make a similar charge for depreciation.<sup>18</sup>

### Presuming What the Testator Would Have Intended

Inadequacy of data and exclusionary rules of evidence may make it impossible to determine what the testator actually intended should be done with regard to depreciation. Moreover, the failure to make express provision probably shows that the testator and his draftsman never envisaged the prob-

<sup>14</sup> But cf. Matter of Talbot, 170 Misc. 138 (Surr. Ct., 1939).

<sup>15</sup> The precise wording of the direction may be vital. In Newbury v. United States, 57 F. Supp. 168, 172 (Ct. Cl., 1944), cert. denied, 323 U. S. 802 (1945), where the testator expressed a wish that the building "... be held together for the benefit of my entire Estate ...," the court held that this "clearly expressed" an intention to charge depreciation to the income beneficiaries. But in Hubbell v. Burnet, 46 F.2d 446, 449 (8th Cir., 1931), cert. denied, 283 U. S. 840 (1931), an authorization to "... charge said property with all necessary, proper and reasonable expenses of maintenance ...," was held not to permit an allowance for depreciation. The court emphasized the detailed provisions for maintenance of the property, which were held to negative any inference of authority to charge income with depreciation.

Depreciation charges based on replacement cost, rather than original cost, would be the best way to assure replacement of the buildings, but judicial refuetance to accept so controversial a method of calculation would probably compel adherence to the traditional "straight-line" concept.

<sup>16</sup> Rogers v. United States, 69 F. Supp. 8 (D. C. Conn., 1946); Re Rose [1940] 1 D. L. R. 139 (N. B. Sup. Ct., 1939). In New York, however, the right to set up a reserve for depreciation seems to be firmly established only where the business is incorporated and the trustee holds a minority interest. Beach v. Wales, 102 N. Y. L. J. 1901 (Surr. Ct., Dec. 1, 1939). Another case permitting depreciation on the basis of proper corporate business management is Matter of Carnill, 93 N. Y. L. J. 1738 (Surr. Ct., April 5, 1935), but the case sidifficult to evaluate because (1) it did not appear what proportion of the stock the trustee owned. (2) the nature of the business was not disclosed, and (3) estoppel was an alternative basis for the decision. It was held in Matter of Adler, supra note 6, that where all the stock is owned by the trustee and the buildings are the sole assets of the corporation, the corporate entity will be disregarded and the "general rule" applied. Cf. Matter of Chapman, supra note 6. But cf. Matter of Hubbell, 119 N. Y. L. J. 554 (Surr. Ct., Feb. 11, 1948) (trustee owned all the stock, but only 50% qua trustee). But see Matter of Jones, 103 N. Y. 621, 624 (1886).

<sup>17</sup> Matter of Girard, 49 Pa. D. & C., 217, 227 (1943).

<sup>&</sup>lt;sup>18</sup> But cf. Matter of Adler, supra note 6 (court disregarded evidence that depreciation entries had been made during deceased's lifetime). The use of the word "income" should not by itself be sufficient evidence that the testator intended it to be computed according to accounting principles. It must be shown that the testator had knowledge of accounting theory and relied on it when he used the word "income."

lem and had no intent at all with regard to it.<sup>19</sup> Our attention then shifts from the unsuccessful search for intent to the area of operative presumptions. These presumptions, or rules of construction, are designed to reflect what would have been intended by most testators, had they been aware of the problem.<sup>20</sup>

Arguments Opposing "General Rule"

Critics of the New York "general rule" have advanced several arguments that it should be presumed that the testator would have intended a depreciation charge against income:

(1) It is asserted that because the testator was familiar with the determination of income in accounting and tax practice, he would have desired income payable to the income beneficiary to be charged with depreciation.21 Had the testator foreseen the problem, however, he probably would have resolved it on the basis of the relative needs of the income beneficiary and the remainderman, rather than by allegiance to accounting principles. Furthermore, the argument not only assumes a present-day general understanding of depreciation accounting, but makes the same assumption for wills executed fifty years ago when depreciation accounting was in its infancy. The argument may be modified, of course, to advocate the application of accounting

principles generally understood by laymen at the time of the testator's death, but this raises a well-nigh impossible problem of proof and would be certain to create more confusion than it would cure.

(2) An argument may also be made that when the testator leaves a building in trust, he is usually thinking of it as a quantum, rather than as a building, and therefore would have desired to preserve intact for the remainderman the amount at which the building was inventoried, subject to fluctuations in value not occasioned by normal wear and tear.22 This does not appear to be a valid generalization. Since the testator's primary concern is usually the adequacy of expected payments to the life beneficiary, it seems more likely that he thought of the remainder vaguely as "something left over" without considering its precise nature.

(4) If the value of corpus is not preserved by depreciation charges to income, payments to the income beneficiary will diminish, possibly to the point of extinction, as the buildings become less productive.<sup>23</sup> Surely, it may be argued, this would not have been desired by the testator, whose primary concern was for the permanent security of the income beneficiary. For many years, however, the failure to charge income with depreciation will more than offset the loss of income

<sup>19</sup> This is most likely to occur when buildings are included in a testamentary trust of the residuary estate. In the case of wasting assets, some cases indicate that the propriety of amortization may depend on whether the gift is specific or residuary. E.g., Matter of Hilliard, supra note 6.

<sup>&</sup>lt;sup>20</sup> See 3 Butler, New York Surrogate Law and Practice § 2462 (1941). It may be suggested that we should not have a presumption, but should try to ascertain what the particular testator would have intended. The objection to such an approach is that by promoting uncertainty, it would unduly encourage litigation.

<sup>&</sup>lt;sup>21</sup> See Hartwig, supra, note 9, at 53: Traver, supra note 5. But in Matter of Wadsworth, 81 N. Y. S. 2d 298, 299-300 (Surr. Ct., 1948), the court said, "The propriety of the accounting practice employed for income tax purposes is not persuasive in considering the respective rights of income beneficiaries and remaindermen."

<sup>&</sup>lt;sup>22</sup> See Isaacs, Principal—Quantum or Res?, 46 Harv. L. Rev. 776, 786-89 (1933): Matter of Housman, 4 Dem. 404 (Surr. Ct., N. Y., 1886). Where a building is not primarily income-producing, but is used as a home, it seems to partake more of the nature of a res than a quantum. It has been suggested that a depreciation charge is improper in such a case. See 2 Scott, Trusts § 239.4 (1939).

<sup>23</sup> Funds withheld because of a depreciation charge should of course be invested in income-producing assets.

caused by declining productivity.24 Also, an income beneficiary can save a portion of the earlier payments to achieve security in later life, or may have other means of support. Thus the validity of the argument rests on the triple assumption that the testator who makes no express provision probably believes that the income beneficiary (a) will live a long time, (b) will prove to be a spendthrift, and (c) will always be dependent on the trust income. Such a situation is patently atypical and the argument must therefore be rejected. However, even though the coincidence of these three assumptions is unlikely in most cases, such considerations may in a particular case militate against rigid application of the "general rule."25

(5) Still another argument is the insistence on terminological consistency.<sup>26</sup> It is assumed that the accountant's definition of "income" is to be applied in any and all circumstances, and that courts refuse to follow accounting theory out of ignorance or excessive obeisance to precedent. While it is true that the courts have sometimes displayed ignorance of accounting theory, opinions which seem "odd" to accountants may often be explained by the different criteria which judges must apply.27 Terminological consistency should be sacrificed when flexibility of definition produces more equitable results. It seems improper to charge depreciation to income merely because of a desire for symmetry.

Arguments Supporting "General Rule"

Among the arguments advanced in favor of retaining the "general rule," the following seem particularly worthy of analysis:

(1) Many decisions rely on the argument that since the remainderman gets the benefit of appreciation, he should suffer any loss caused by depreciation.<sup>28</sup> This ignores the dual nature of depreciation. When we speak of charging income with depreciation, we are concerned with the inevitable kind of depreciation caused by normal wear. tear and obsolescence. Once this is charged to income, it is clear that the unpredictable"market-fluctuation"kind of depreciation—the proper analogue to appreciation—would be chargeable to principal. Thus the logic of the argument is more apparent than real.

(2) Many cases have attempted to justify the "general rule" on the ground that the computation of depreciation is a guess of uncertain reliability, since (a) annual appraisals of value are undependable,29 (b) it is difficult to predict the life of a building, 30 and (c) replacement cost cannot be foretold.31 It should be noted that these objections intermingle three distinct methods of calculation. While the appraisal and replacement cost methods generally involve considerable guesswork, the customary "straight-line" method has become sufficiently standardized to de-

<sup>24</sup> In fact, the total of income payments will almost always be greater if no depreciation charge is made, no matter how much each annual payment diminishes.

<sup>&</sup>lt;sup>25</sup> For example, when the income beneficiary is a prodigal invalid who is expected to outlive the buildings, it would be unwise to apply the "general rule" blindly, ignoring completely its consequences in later years.

26 See Hartwig, supra note 9, at 43-48.

<sup>27</sup> See, e.g., Randall v. Bailey, 23 N. Y. S.2d 173, 179, 183 (Sup. Ct., 1940), affd., 288 N. Y. 280 (1942).

<sup>&</sup>lt;sup>28</sup> E.g., Evans v. Ockershausen, 100 F.2d 695 (App. D. C., 1938); Matter of Adler, supra note 6; Matter of Edgar, supra note 6.

<sup>&</sup>lt;sup>29</sup> See Matter of Chapman, supra note 6, at page 192.
<sup>30</sup> In Matter of Edgar, 157 Misc. 10, 13 (Surr. Ct., 1935), the court stated that too high a depreciation rate would have the alarming result of charging income with more than the cost of the building. This is obviously fallacious, for (1) the depreciation rate may be adjusted when shown to be inaccurate, and (2) additional depreciation charges should not be made for buildings which have been fully depreciated.

31 See Smith v. Keteltas, 62 App. Div. 174, 180 (1st Dept., 1901).

vitalize the objection of uncertainty.32 Moreover, even though some element of conjecture remains, the basic question is not which rule is simpler, but rather how we can best effectuate the testator's putative intent.

(3) The most cogent argument advanced in support of the "general rule" is that it favors the income beneficiary, whose adequate security is usually the testator's primary concern. Although it is impossible to prove objectively that most testators are less interested in the sufficiency of the remainder, this proposition finds support in the observations of experienced practitioners.

### Presuming Discretion in the Trustee

It may be argued that we should presume an intent to give the trustee discretion, since this solution achieves flexibility without the necesssity for repeated recourse to the courts. Carefully drawn wills, it is pointed out, often give broad discretion to the trustee because he can best assay the future needs of the income beneficiary and remainderman.33 However, there are three deterrents to adoption of this suggestion: (a) since the trustee has not been given a power to determine principal and income, it is unrealistic to assume that the testator would have given him discretion as to depreciation; (b) there appears to be judicial reluctance to adopt rules of construction which enlarge the powers of trustees; (c) a trustee might be subject to surcharge when his past adherence to the "general rule" constituted an abuse of dis-

### Conclusion

Need for Judicial Adherence to "General Rule"

Most of the contentions advanced to support or attack judicial adherence to the "general rule" forbidding charges to income for depreciation without express testamentary authorization are either specious or inconclusive. The only argument of compelling strength is that the "general rule" expresses what most testators would have intended because the income beneficiary is usually the primary object of the testator's bounty. Moreover, even assuming a contrary rule were desirable, it would be unwise to reverse the "general rule" by judicial decision, since this would subject trustees, who have long relied on the "general rule,"34 to surcharge, and would make income beneficiaries liable for past excessive distributions.

The "general rule," however, should not be applied so rigidly as some statements of it seem to require.35 The presumption should give way when the testator's actual intent is manifested by evidence other than express direction, or where exceptional circumstances make it abundantly clear that blind application of the "general rule" would completely subvert the purpose of the trust.36

### Undesirability of Legislative Change

While it is clear that no statute should be adopted making depreciation charges to income mandatory, there is need to examine more carefully the desirability of a statute giving the trustee discretion. Divergent views taken in recent statutes illustrate the split in professional opinion concerning the wisdom of such legislation. The Uni-

<sup>32</sup> The standardization of depreciation rates was given great impetus by the promulgation of Bulletin "F" by the Bureau of Internal Revenue in 1931. See 2 P-H 1949 Fed. Tax Serv.

<sup>33</sup> See Stephenson, Discretionary Powers of Trustees Under Wills and Trust Agreements 3 (1937).

 <sup>34</sup> See 2 Scott, Trusts § 239.4 (1939).
 35 The conflict between the desires for flexibility and predictability in rules of construction is well illustrated in Matter of Stevens, 187 N. Y. 471 (1907).

form Principal and Income Act implicitly adopts the "general rule," <sup>37</sup> but Alabama and Delaware have enacted statutes giving the trustee broad discretion. <sup>38</sup>

Although the draftsmen of the Uniform Act were undoubtedly swayed by the simplicity<sup>39</sup> and customary acceptance<sup>40</sup> of the "general rule," they must also have been greatly influenced by the likelihood that the testator would have favored the income beneficiary. Moreover, they must have been aware of the difficulty of propounding criteria to govern the exercise of discretion.<sup>41</sup> The Alabama and Delaware statutes

were probably motivated by a fear that the "general rule" would be too stringently applied to all situations where the will contained no express provision.

The writer believes that there is no need for remedial legislation in New York, so long as our courts may apply the "general rule" flexibly, recognizing its inapplicability where intent is clearly inferrable, or where "extraordinary circumstances" are shown to exist. Admittedly, it will require litigation to mark out the periphery of the "general rule," but the alternatives of an inflexible rule or discretion in the trustee are less desirable.

### Early Development of Accountancy in New York State

derstand their scope fully, to know how they will be dealt with by judges trained in the past which the law embodies, we must ourselves know something of that past. The history of what the law has been is necessary to the knowledge of what the law is."

Recently an injunction was granted by Justice Samuel Null of the New York State Supreme Court staying the hands of the wreckers of Castle Clinton, better known to the present generation as the Aquarium. In his opinion granting the injunction Justice Null said, inter alia:

"A people indifferent to the landmarks

and monuments of its past will not long retain its capacity to achieve an honored future."

Certain it is that the pioneers of accountancy in New York had the vision, the courage and other attributes so essential for the present day success of the profession of accountancy and left a debt most difficult for the present generation to discharge. Such a heritage should be jealously guarded, to the end that the public be served in a manner which reflects credit upon the individual members and the profession as a whole.

<sup>&</sup>lt;sup>37</sup> The Uniform Principal and Income Act, with modifications, has been adopted in Alabama, California, Connecticut, Florida, Illinois, Louisiana, Maryland, North Carolina, Oklahoma, Oregon, Pennsylvania, Texas, Utah and Virginia.

<sup>&</sup>lt;sup>38</sup> Ala. Code, tit. 58, § 86(5) (1940); Del. Rev. Code, c. 117, § 35A, added by Del. Laws

<sup>1939,</sup> c. 150, § 1.

39 The desire for simplicity is particularly emphasized in the Introductory Note to the Third Tentative Draft of the Uniform Act, where it is asserted that ". . . the probable intent of the creator of a fund for the benefit of a tenant and remaindermen is for as simple a system of distribution of his bounty as is possible." Handbook Nat. Conf. Comm. on Uniform State Laws 341 (1930). The Prefatory Note to the final draft of the Uniform Act, however, places somewhat less stress on the need for simplicity. Handbook Nat. Conf. Comm. on Uniform State Laws 326 (1931).

<sup>&</sup>lt;sup>40</sup> See the Introductory Note to the Uniform Income Apportionment Act, which was the First Tentative Draft of the Uniform Principal and Income Act, Handbook, Nat. Conf. Comm. on Uniform State Laws 206 (1928).

<sup>41</sup> The Alabama statute, note 38 supra, purports to establish criteria, but the Delaware statute, note 38 supra, is in the broadest possible language. Among the problems arising when wide discretion is conferred are: (1) whether discretion extends to the method (i.e., straight-line, replacement cost, etc.) as well as to the rate; (2) whether the relative needs of beneficiaries are to be considered; (3) how often discretion is to be exercised. There is a danger that some trustees, over-awed by accounting conceptualism, will charge income with depreciation without intelligently exercising discretion.

# Toward Better Accounting Personnel Administration

By WERNER E. REGLI

I we the field of personnel relations, an accounting firm presents a unique challenge. Its staff generally runs the whole gamut of experience, from highly qualified skilled accountants to neophytes just beginning their apprenticeships. However, because of the professional bond which unites their efforts, the usual barriers so often existing between employer and employee, or employees of different ranks are often considerably reduced or even entirely eliminated, to produce a well-balanced group working as a professional team. Therein lies the basis for a difference in the approach to personnel relations by an accounting firm.

Aside from the purely administrative aspect of the problem, the necessity for the maintenance of a harmonious, disciplined, efficient and well-trained staff is further accentuated by the position recently taken by the Committee on Auditing Procedure of The American Institute of Accountants in the report entitled "Tentative Statement of Auditing Standards," viz., the personal or

Werner E. Regli is the personnel director of a New York firm of Certified Public Accountants. He has had an extensive background of experience in public practice, particularly in the field of Consumer Cooperatives and non-profit organizations. He is the author of A Primer of Bookkeeping for Cooperatives (1937).

During World War II, Mr. Regli served in the Inspector General's Department, his chief duty being the inspection of troop transports, on which subject he prepared a manual. He was retired with the rank of Lieutenant Colonel. general auditing standards, which are equally applicable to the standards of field work and the standards of reporting, require (inter alia) that the generally recognized normal auditing procedures be applied with professional competence by properly trained persons.

In the light of this situation, what personnel methods and incentives can be utilized by an accounting firm to encourage its staff to greater effort and consequently, recognition and reward in the process of self-development and professional maturation? The following four propositions are offered to help achieve a more equitable and objective administration of the personnel problems of a medium-size accounting practice.

First, there must be an acceptable tabulation of those human qualities, i.e., those character and personality traits and professional aptitudes, which are recognized as prerequisite to success in this field. Then, an accurate means of measuring the extent of their presence at any one time in any given individual must be devised. (See Form 1 and accompanying instruction sheet).

Second, a method is needed to determine, as objectively as is possible, the efficiency of an individual with respect to his work habits and his attitude towards his job. Such an evaluation is relatively simple, as is illustrated in Form 2. (Form 1 may be likened to a balance sheet, since its purpose is to appraise an individual's human qualities "as of now." Form 2 may be compared to an operating statement, since it is concerned with the action of an individual over a period of time.)

Third, the policy on compensation and promotion should be known to all.

## FORM 1

# EVALUATION OF CHARACTER AND PERSONALITY TRAITS

	AND PROFESSIONAL APTITUDES
9	Vame: As of: (date) Grade: Evaluation made by: (Read instructions below carefully before scoring)
	CHARACTER AND PERSONALITY TRAITS
Yes/No * 1	Integrity (includes conscientiousness, honor, absence of expediency)
7 2	
2	Generosity (desire to give of himself; ability to admit error)
0	Patience (includes consideration and tolerance)
4	Sense of justice (includes the capacity for fairness and reliability) Common sense and sound judgment (ability to compromise provided it does not conflict with integrity)
Yes/No * 6	Sense of humor (to help keep a sense of proportion and perspective)
7	Recognition of his own limitations
8	Self-interest (includes will and perseverance, considering others; maintaining a healthy mind and body)
9	Imagination (includes the use of creative as well as critical intelligence)
10	Initiative (includes ability to assume and also to delegate responsibility)
11	Potentiality for growth (includes flexibility and adaptability)
12	Potentiality for leadership
	A quiet, contained manner
14	Neatness in appearance
14 15 16 17 18 19	Alertness
16	Thoroughness
17	Diligence
18	Tact
19	Ability to recognize the value of team work
20	Ability to work under adverse physical conditions
21	Ability to act on his own responsibility
22	Ability to handle a difficult situation
2.5	Habits of orderliness, punctuality, and accuracy
24	Habit of writing legibly
	PROFESSIONAL APTITUDES
Yes/No *25	Love of the profession
Yes/No *26	Aherence to professional ethics
27 28 29 30	Ability to differentiate between minor and major things
28	Ability to think clearly and to advise fearlessly
20	Ability to defer criticism and decisions until all facts are in
30	Ability to recognize that criteria and standards are guides and not absolutes
31	Ability to identify himself with his client's aims
32	Ability to express himself in words and in figures, both orally and in writing
33	Ability to receive and give instructions with consideration for others
32 33 34	Ability to act as impartial observer in advising management
35	Readiness to acquaint himself with client's business
36	Potentiality for the development and expansion of an accounting practice
	totellianty for the development and expansion of an accounting practice

<sup>\*</sup> Strike out the inappropriate answer.

INSTRUCTIONS FOR SCORING

The purpose of this score is to try to obtain an unbiased evaluation of each accountant on the staff. This score is not to be confused with the report on work habits and attitudes.

This score is to be used as a guide in arriving at the evaluation of the individual. It must, therefore, be considered a relative, not an absolute rating.

Where there is virtual agreement on a score by all the evaluators, there will be little need for discussion; however, where there is disagreement, the causes thereof must be determined and resolved.

There are four questions to be answered "yes" or "no". If the answer is "no" with respect to three of them, viz., Integrity, Love of the Profession, or Adherence to Code of Professional Ethics, further scoring is unnecessary because employment with the firm depends upon the possession of these three basic traits.

Below is the rating scale to be used in scoring, with the verbal equivalent of the number score. Choose the most appropriate numerical rating for each characteristic listed and write that number in front of it in the column provided for the purpose:

RATING SCALE		Score
Superior: outstanding	A+	45 to 50
Excellent: vory officient: well above average	∫ A—	40 to 45
Excellent: very efficient; well above average	) B+	35 to 40
Satisfactory: above minimum standards; reasonably efficient	ficient B-	30 to 35 25 to 30
Sansjuctory, above minimum standards, reasonably e	melen) C+	25 to 30
Barely Passable: just meets minimum standards; limi	ted C-	20 to 25
Lovery 1 assurer, just meets initindia standards, min	D+	15 to 20

In this way, the individual will know his earning potentiality and the basis upon which it may be projected into the future. Form 3 provides a specimen compensation policy for staff accountants and includes factors to be considered in computing salary increments. (A compensation policy should, of course, also be worked out for the clerical staff.)

Fourth, each individual should know his place on the team and understand not only the working of the team as a whole, but also his individual relationship and responsibility to it. Form 4, which is offered as a specimen functional chart for an accounting firm, should be made available to all personnel within the organization.

# Evaluation of Character and Personality Traits and Professional Aptitudes

It was in trying to work out the definitions of human qualities for our organization that we asked ourselves this question: "If you were asked to describe the ideal public accountant, what would your answer be?" Since none of us had ever taken the time to sketch our "hero," we decided to ask each member of our accounting personnel to record what he thought should be the attributes of the ideal public accountant.

Most of the descriptions were selfportraits, based partly on reality and partly on wishful thinking. In many, there was an amazing lack of clarity, both in the visualization of the ideal and in its portrayal. Once the stage of experimentation with "creative" composition was over, however, and each accountant took hold of the problem, things began to happen.

A comparative analysis of the papers was a matter of columnar tabulation and resulted in an interesting group expression. Our "superman's" attributes fell into two groups which we arbitrarily designated as Character and Personality Traits and Professional

Aptitudes. We found that the composite result was a guide and a standard both of what we want to be and of what we expect of others.

Being accountants, once we had agreed upon and tabulated a set of human qualities, we naturally had to follow through with some sort of yardstick. The instructions for scoring, accompanying Form 1, will serve to explain our scoring method.

We realized that there were problems to be faced in the use of any evaluation forms constructed largely along subjective lines. However, since each staff accountant is graded by four or five people, the several evaluations, considered together, become a more objective instrument. If there is agreement among those making the evaluation, little further discussion will be necessary except to fit the individual most satisfactorily into the over-all plan of the office. If there is disagreement, however, the causes will have to be determined and resolved.

The evaluation form may be used for all grades of accountants: junior assistants, senior assistants, seniors, and supervisors. We find that we make more varied demands, in smaller doses, on a junior than on a senior or a supervisor. A supervisor without much tact or diplomacy, without patience and consideration, might still be preferred by a client as his accountant because of his qualities of thoroughness, sound judgment, ability to identify himself with his client's aims, and ability to differentiate between minor and major things. Or, an accountant with a sense of justice, common sense and sagacity might well lack generosity and patience; even so, with a proper combination of character and personality traits and professional aptitudes, he might still attain a high rating.

# Evaluation of Work Habits and Attitudes

It is our opinion that an evaluation of work habits and attitudes of staff accountants should be made at least twice

# EVALUATION OF WORK HABITS AND ATTITUDES

	me:	o (date)
1. 2. 3. 4. 5. 6. 7. 8. 9.	Has he been able to work well with people? Has he carried out instructions? Has he applied himself well to the job? Have his work-papers been up to standard? Has he been able to express himself clearly in words and in figures? Has he been able to write good, understandable English?	scale, below.
	Is he ready for more responsibility? (Yes or No)	
Co	mments:	
	RATING SCALE Superior: outstanding	Score
	Excellent: very efficient; well above average	- 40 to 45 + 35 to 40
	Satisfactory: above minimum standards; reasonably efficient	+ 25 to 30
	Barely Passable: just meets minimum standards; limited	

# Form 3

# COMPENSATION POLICY FOR STAFF ACCOUNTANTS

(Based on present conditions)

Classification			Weekly Salary Range
Juntor Assistants	3 *		\$40 to \$55
Junior assistants are	employed on a trial	basis for two to four	weeks at \$35 a week.

Additional compensation in the form of bonuses may be given, based on the earnings of the firm.

FACTORS CONSIDERED IN THE COMPUTATION OF SEMI-ANNUAL SALARY INCREMENTS

	Factor	Maximum Percentage Allocated
	Character and Personality Professional Aptitudes and Training and Work Habits a	
3.	Attitudes Loyalty Length of Service **	40
		100%

<sup>\*\*</sup> Increments for length of service are discontinued after two years of employment.

A special increment is also granted upon receipt of the C.P.A. certificate.

a year, whereas the evaluation of character and personality need be done only once a year. Character and personality traits, as well as professional aptitudes, change slowly. In some respects, they may have reached high level in the junior grade. On the other hand, our junior assistants are only beginning to perfect work habits and attitudes when they step out into their first jobs. It takes maturity to appreciate the fact that one's work habits and attitudes very often determine the use one makes of his basic endowment.

The form (#2) for the evaluation of work habits and attitudes is a simple one. We believe that if the members of the staff are scored frequently by several supervisors in each case, bad habits may be corrected and, what is even more important, new ones may be formed which will assist the individual in the full development of his talents and faculties.

A uniform method of evaluating the members of an accounting staff furthers the solution of a number of problems, not only those of rating individuals and comparing them, but also those of promotion and salary increases. It aids in the evaluation of the composite talents of a staff and reveals deficiencies. A uniform method of evaluation has helped to build a uniform basis of thinking and this, in turn, should help to build and maintain a staff of high caliber. It should also reduce distortion in judgment on the part of those making the evaluation caused by a domestic disturbance or, for that matter, by an excellent breakfast.

Finally, and by no means least important, working together on evaluation forms developed, at our top level, a more uniform approach to the always vexing problem of objectivity and fairness in personnel relation.

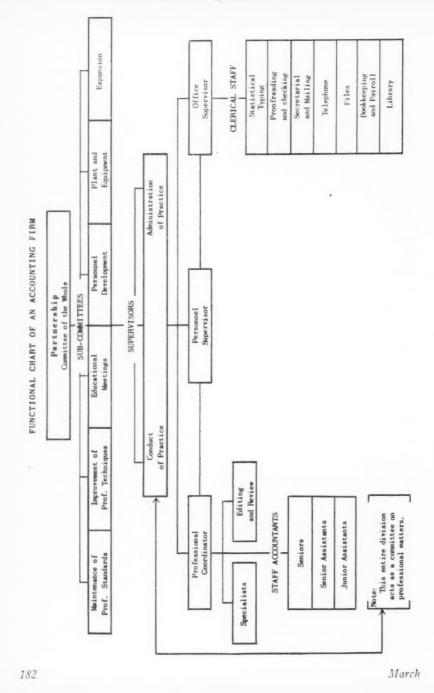
# Compensation and Promotion

To develop into a competent public accountant, certain combinations of character and personality traits are essential. An individual must be proficient not only in his acquired skills; he should also possess good business sense. We believe that our responsibility with respect to young people trying to find their place in the profession is twofold; We are responsible to them in training them as individuals, and we are responsible to the profession in developing them as well-qualified technicians.

We know that some young people "get by" their theoretical training in school but, when they get out into the field, they are neither fitted nor qualified for the exigencies of the profession. Young applicants for positions should be screened to assure their fitness. Mistakes in the choice of a field of endeavor do occur; then, it is up to us to try to help these young people to realize that it would be better for them to choose another field. A final question we ask ourselves is this: Does this young person possess the human and pofessional potentials necessary for the kind of individual that we visualize as a member of the firm?

Financial security plays a large part in an individual's satisfaction with his job. This security is concerned not only with the compensation received at a given time; it is concerned as much with the prospects of advancement and the rate of such advancement. Therefore, the compensation policy of a firm should be known by all staff accountants (Form 3).

We have three classifications for our staff accountants and we indicate the corresponding compensation and the maximum possibility for advancement. Under present conditions, a junior assistant may soon begin to shift over into the senior assistant group. A staff accountant knows that once he has reached the \$50 a week compensation range, he may be beginning his metamorphosis. If he is not making the grade, he will be so informed by his supervisors and the personnel director; he will also be aware of it as his salary increases will lag. All of these factors will help him to realize that he must mature and develop further or, per-



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haps, as far as this firm is concerned, he may already have reached his maximum. Thus, he is in a position to replan and rearrange his future. The same process holds true on the next higher level. At the end of four years, a senior assistant may reach \$75 a week and further promotion may not be possible because of his own limitations. The top level of the staff accountants, that of senior, is attained when the members of the firm decide that a particular individual is outstanding in actual and potential value and is able to work independently.

This compensation policy is administered by those in charge of granting promotions and salary increases, and is used to determine whether or not an individual is to be held back.

Two of the four factors entering into consideration for promotion—human qualities and professional aptitudes—have already been discussed. The factor of loyalty depends upon the judgment of the supervisors; length of service is automatic.

It is important to keep an individual file for each member of the staff. This will build up a "case history" if all the pertinent data concerning an individual are recorded, and will eliminate reliance on memory, as well as possible misunderstandings.

# Functional Chart for an Accounting Firm

An analysis of the papers describing the ideal public accountant, referred to above, indicates that our "superman" must lead a dual existence if he is to succeed in public practice. One of his lives must be spent as a professional performing services for his clients regardless of personal consequences; in a sense, he must live the life of a research scientist, concerned only with his science and divorced from the problems of keeping up the laboratory and paying expenses. His other life is that of the entrepreneur, using his imagination and skills to create, expand and profit-

ably operate the business which makes it possible for him to practice his profession.

The functional chart for a mediumsize accounting firm (Form 4) illustrates the duality in the operation of an accounting practice; this duality is expressed in the professional and the administrative aspects. The committee of the whole, the partnership, divides itself into sub-committees which are concerned with professional matters, administrative affairs and personnel activities,—everything required to assure an even flow of productivity as far as all functions are concerned.

The committee of the whole then transforms itself into a body of supervisors, their function being squarely dual: one, the conduct of the practice, the other the administration of it. There are three service divisions, or liaison points: professional co-ordination; office management; and personnel supervision.

Personnel reaches over into both the professional and the administrative life of the firm. Employment, dismissal, personnel development, meetings, coordination on the personal level, and all the other accepted functions of personnel management are concentrated here, always, however, subject to the policy-making body, the partnership.

Office management is concerned with the smooth operation of the administrative services which are required to implement the professional practice. The clerical staff is responsible to office management for results as to performance and efficiency. This division acts as a service organization for the professional side of the business. It also furnishes the services required in the administration thereof. It maintains a file of office memoranda to keep the entire staff informed as to current administrative policies and issues new memoranda as the need arises.

Professional coordination is responsible for the standards and quality of the professional work. The entire professional staff operates under the pro-

fessional coordinator. Specialization in accounting is developed under his direction. Professional coordination is exempt from the task of seeing to it that bills and payrolls are met; cost of performance is considered on the next higher level: that of the supervisors. The professional coordinator is responsible for the preparation of a technical manual and a style manual.

The professional staff may also act, at times, as a committee of the whole to consider professional matters. Here the supervisor with many years of experience works on an equal basis with the cub junior. Here we meet as fellow accountants to discuss professional matters, ideas, or what have you, but not the conduct of the business as such.

In the last analysis, our job is threefold—learning, carrying out assignments, and teaching. We must impart our knowledge freely to promote the growth and development of our profession; we must be willing to continue to learn in order to progress.

Accounting is not an exact science; it must be dynamic and able to adapt to a changing world. The profession must be served by individuals who are willing to learn new methods and absorb new ideas. Accounting is not just another job; it is a continuing process of education and, as W. L. Jacks of Manchester College said:

"You educate a human being most effectively not by giving him a culture which he can make use of only in his leisure time, but by training him to achieve excellence in his working time. . . . The object is to train him to exercise his vocation as though it were a fine art, to find the road that leads to the most excellent way of fulfilling it, so that the process of his living—this trade, this profession, this handicraft—shall become at the same time a process of developing his highest faculties of mind and character."



# The Accountant and the Paragraph

By JOHN MANTLE CLAPP

THE other day one of my accountant The other day one of the friends was deploring what he called the clumsiness of much accountant writing. "I'm not thinking of our audit reports," he said, "but of the papers at a meeting, often published later in a professional journal, and in too many of our memorandums and letters-those of my own firm like all the rest. Clumsiness means awkward performance of what you undertakeclumsy walking, clumsy dancing-and there's too much of that about our deliverances. They have an unfinished air, like a home carpenter job that isn't quite right!"

My friend was much too critical of his profession, I felt, and yet there might be something in what he said. It occured to me that the trouble might be caused, in part, by neglect of the fourth Unit of Rhetorical Structure, the one that is least known, the Para-

graph.

A paragraph is the complete assembly of an idea. In that it differs from the smaller Units. The words are individual building-blocks in a rhetorical edifice; a clause or phrase combines them in a first sub-assembly; then a

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sentence combines the sub-assemblies into a statement or remark. Finally a paragraph weaves a group of sentences into logical sequence. Properly building the paragraphs points up a writer's thought so that it holds attention, so that readers grasp and savor what he presents. A fine illustration of what I mean is the second paragraph of the paper on "Accounting Principles and Cost Accounting" in this magazine, last December-

"Accounting in any area is the art of recording, analyzing, interpreting, and reporting business transactions. What differentiates cost accounting from other accounting? It appears to me that its chief characteristic is that it is directed, as its end result, to the requirements of management. Financial accounting is concerned chiefly with the requirements of creditors, owners, the Government, prospective investors, and persons outside of the management. Generally accepted accounting principles, in other words the prevailing ideas about accounting in general, have been molded for the most part by the requirements of persons outside of the business itself. It may be fruitful to inquire as to how the characteristics of cost accounting, i.e., accounting for the use of management in connection with its responsibility to manage, differ from those of accounting directed to outside persons.'

In 133 words these six short sentences give a reader a jump-off for the entire discussion; they are both clear

and interesting.

Or consider the sixth paragraph of the American Institute's Accounting Research Bulletin No. 32, issued in December, 1947. In five sentences totalling 197 words it outlines in detail the two concepts to be discussed-

"The question of what constitutes the most practically useful concept of income for the year is one on which there is much difference of opinion. On the one hand, net income is defined according to a strict proprietary concept by which it is presumed to be determined by the inclusion of all items affecting the net increase in proprietorship during the period except divi-

dend distributions and capital transactions. The form of presentation which gives effect to this broad concept of net income has sometimes been designated the 'all-inclusive' income statement. On the other hand, a different concept places its principal emphasis upon the relationship of items to the operations, and to the year, excluding from the determination of net income any material extraordinary items which are not so related or which, if included, would impair the significance of net income so that misleading inferences might be drawn there-This latter concept would require the income statement to be designed on what might be called a 'current operating performance' basis, because its chief purpose is to aid those primarily interested in what a company was able to earn under the operating conditions of the period covered by the statement."

Neither of these passages would ever be called clumsy.

Unfortunately, in the papers read at meetings or published in professional journals, passages like these, effectively focusing the content of a group of sentences, are too infrequent. Apparently many accountants who have worthwhile thoughts to present have too little understanding of the paragraph's function and what it can do for them. I recall a lecture in a tax course, the material excellent and the presentation -so far as wording and sentence structure were concerned-most careful. But the 2,250-word paper was broken into 42 paragraphs, an average of 53 words to the paragraph. As the paper contained 65 sentences or remarks, averaging 34 words to the sentence, it is obvious that the paragraphing contributed virtually nothing to the general effectiveness. Yet only slight rearrangement and retouching may be needed to turn a procession of separate remarks into rounded, logical Units.

In truth, the technique of building good paragraphs is much less difficult than the technique of building good sentences. For in laying out a paragraph you do not have to allow for the dead hand of Custom. The paragraph is a newly developed rhetorical form, associated with writing, not with talk, and it is controlled entirely by Logic.

This fact, that the paragraph is relatively a new form, explains why so many persons—not only accountants fail to utilize its resources. Paragraphs, groups of sentences welded into logical sequence, are not a part of our traditional language equipment, like the words, the clauses and phrases, the sentences. In talk, at least in conversation, they are unknown; one of the talkers will utter a few remarks and then toss the ball to another man, or the other man will interrupt-neither party waiting for a complete logical Unit to be worked out. While paragraphs figure largely, of course, in public speaking, that is out of the ken of most persons, certainly of many accountants. Paragraphs, indeed, do not come into our lives until we begin to write compositions at school, and then too often the directions we receive may amount to little more than: "Put in a paragraph break about every so often; it makes the page look easier to read."

The history of the paragraph form is somewhat as follows. In old-time writing a small-size assembly of thought, such as today would make up a paragraph, would find expression only as a minor item in one of the Latinized giant-sentences of the day, its elements crammed somehow into the big grammatical word-heap. Specimens of these grammatical dinosaurs survive today in the writing of lawyers, and in the Balance Sheet Notes of some accountants. After the invention of printing, however, it became profitable to offer the general public pamphlets and little books on current political and religious issues. It was found that the new readers could not grasp the long sentences of the big old books. Attention began to be directed, accordingly, to small-size assemblies of material, and during the 17th, 18th, and 19th centuries the modern paragraph gradually took shape, in newspapers and magazines, in books, and then in various types of Utilitarian writing-Sales Letters, Advertising Copy, Reports.

Finally, about the end of the 19th century, the technique of the new rhetorical form was definitely set down. One brief and clear description of it was that of two American teachers of English, Fred M. Scott and J. V. Denney, in their book on "Paragraph Writing." Today the technique they described has become a part of regular courses in Composition. But the nature and function of paragraphs is still little known to many persons who pay careful attention to words and sentences. Treatment of the paragraph in college and school is still rather sketchy. It comes toward the end of the course, when students are usually allowed to turn away from textbooks to "writing their own stuff." In consequence a good many young people go forth from the halls of learning even now with scant knowledge of the fourth Unit of Structure, which might aid them materially in writing their own stuff better.

The technique of the modern paragraph may be summed up in two requirements. First, there must be a unifying idea running through a collec-This paragraph tion of thoughts. nucleus, commonly called the Topic, is usually presented in the opening sentence, but it may be placed later, or may nowhere be explicitly stated. Secondly, the various items covered by the Topic must be arranged in a series of sentences that follow a logical Pattern, one that readers can trace easily. These requirements, obviously, are simple. Getting effective command of paragraphing does not call for the long, detailed effort involved in becoming acquainted with words, nor yet the complexities involved in balancing Logic and Custom in clauses, phrases, and sentences. In paragraph structure the logically-minded accountant can speedily get results.

Accountants as a rule meet these requirements very satisfactorily, so far as selecting good ideas to express and arranging them in good order. Too often, however, they fail to make clear what

they are doing and why. They do not bear in mind what an experienced teacher learns never to forget, the need of putting one's best foot forward when engaged in the difficult task of exposition. Checking through last year's file of the Journal of Accountancy and the New York Certified Public Accountant may be helpful in showing the success of their contributors in meeting these paragraph requirements.

First, as regards clear indication of the Topic. Many paragraphs in the paper on Cost Accounting already cited, in the New York Certified Public Accountant for December, 1948, make a particularly good score on this point. Paragraph 2, already quoted, opens the main discussion, but the writer precedes it, in Paragraph 1, with a four-sentence introduction to the entire paper.

The paragraph quoted from Bulletin No. 32 does not get off to quite as good a start; its first sentence is too inclusive, leading one to expect a discussion not of two opinions only but of several. As an example of clear discrimination between the two concepts to be discussed, however, it is excellent.

In the Journal of Accountancy for January, 1948, line 6 in the second column of page 11, the Topic is presented in the second sentence—

"This raises the second fundamental requirement that has emerged during the past year. The income statement must be designed to be useful to the 'non-insider.' The 'insider'-by which I mean the management or directors closely familiar with the business, or stockholders who are running their own business or are active in it-needs no particular analysis of the income account. He knows the importance and relevance of various items, and whether items not at all related to a year are included in the determination of income. He is in a position to make his own allowances for items not relevant to the year's operation. The great majority of accounting reports are being prepared for insiders—for the man who has intimate knowledge of the operations of the business. But while reports to insiders are more numerous, it is in the smaller field of reports to noninsiders that income presentation must stand its test. For such readers, it is not sufficient to treat special items by disclosure, and

leave to the reader the decision as to the weight to be given them. William Blackie, in his article explaining the financial statements of Caterpillar Tractor Company, stated this very clearly. He said, 'They, the readers, were to be the audience, not auditors—a distinction sometimes missed by the critic.' Responsibility is on the issuing corporation and on its public accountants to interpret the items for the reader, and to segregate those items which affect the income for the year from those which are not to be considered in judging the efficiency of operations for the year."

Turn now to the patterning of the paragraphs. Notice how simple these Patterns are:

In the December, 1948, paper in the New York Certified Public Accountant this is the Pattern:

Sentence 1. Definition of Accounting in general.

2 and 3. Definition of Cost Account-

" 4 and 5. Generally accepted accounting principles result from requirements of persons outside of the business.

" 6. Perhaps the requirements of Cost Accounting, on the part of persons within the business, differ from those covered in sentences 4 and 5.

In Bulletin No. 32, paragraph 6, the Pattern is:

Sentence 1. Topic: The question of etc. is one on which there is a difference of opinion.

" 2 and 3. Description of one concept.

" 4 and 5. Description of the other concept.

In the paragraph on page 11 of the Journal of Accountancy, January, 1948, the Pattern is:

Sentence 1. Introduction to the body of the paper.

" 2. Topic of this paragraph.

" 3, 4, 5, 6. Negative proof of Topic.

3, 4, 5, 6. Negative proof of Topic.
7, 8, 9, 10. Positive proof of Topic.
11. Topic restated and emphasized.

Of course, the paragraph patterning of the year's papers is not always as simple and clear as in these specimens. In *Bulletin No. 32*, for instance, paragraph 14 is somewhat hard to follow. The later paragraphs in the December,

1948, paper in the New York Certified Public Accountant are still more difficult for a reader to follow. When weighty and complex material is to be presented, perfect simplicity is not always to be counted upon. In most cases, however, the patterning of the papers in the two magazines is good, throughout the year.

A point that should be noted with regard to these papers and articles is the large use of connectives as an aid in weaving sentences together. In reports and memorandums, where compactness is felt to be all-important, the same writers would probably insert very few connective words or phrases. The connectives employed in these papers, it may be observed, are but rarely conjunctions; they are generally pronouns, either demonstrative or personal. The device of parallel construction, also, is often employed. In the 7th paragraph of Bulletin No. 32, which comprises six sentences, sentences 2, 3, 4, and 5 begin with the pronoun "They," and the sixth sentence is tied into the series by the phrase "this group," after an initial modifying phrase.

Analysis of the paragraphs noted above—and the professional magazines of last year contain others virtually as good as these-reveals that the paragraph formula, as they exhibit it, is nowise revolutionary. Essentially, it is the age-old structural scheme for an entire composition, whether an article or a volume. Present-day Utilitarian writing merely applies the formula definitely to a small-size assembly of material. In general it may be said that the logically-minded accountant should experience little difficulty in carrying through the application of the formula in his own writing. Yet in managing satisfactorily all the paragraphs in an extensive paper the accountant will need to be on his guard against two major sources of trouble. One of these results from his special habit and attitude of mind. The other is a difficulty that presents itself to all persons engaged in serious Utilitarian writing.

The first of these major difficulties is the accountant's tendency to use too many short paragraphs. Accountant writing tends toward fragmentation, the setting off in paragraph form of items of material which are in fact merely single remarks. The tax lecture mentioned on an earlier page is an example. When 65 sentences, totalling 2,250 words, are presented in 42 paragraphs, it is evident that there has been no weaving of remarks into rounded sequences. Instead, the writer has merely labelled separate remarks as paragraphs. This over-use of short paragraphs-often single-sentence paragraphs—is especially common among accountants, possibly because of the convenience of single-sentence paragraphs in disposing of brief comments on items in a Balance Sheet. The logically-minded accountant should recognize that pinning upon a remark the label that belongs to a closely woven sequence is not logical.

I recall the maxim of an old editorial acquintance of mine, when a manuscript appeared at the office peppered with such single-sentence paragraphs: "Work it in; work it up; or work it out!" That meant: When such a splinter item or idea presents itself, try to combine it with something to which it is related. If that proves impracticable, try to expand it to a size that is usual with other passages in the paper. But if neither of these courses is possible, drop the item; to keep it, and thereby throw out the perspective of your presentation will do more harm than good.

The maxim of my experienced editor friend bears also upon the second of the major difficulties in handling paragraphs. This is the maintenance of a proper balance in the presentation. The old hand learns the wisdom of avoiding both monotony and irregularity in such points as length of sentences and paragraphs, repetition of pet phrases, and similar features of what used to be called "style." Inadvertently, when discussing a serious matter, one may run

along with sentence after sentence of virtually the same length, or with the same opening phrase, or with emphasis falling at the same point, so that readers find the passage monotonous. That is certainly one aspect of clumsiness.

On page 208 of the Journal of Accountancy for March, 1948, in column 2, there is a paragraph of 9 sentences, filling 30 lines—sound ideas expressed in short, crisp sentences. But the word-lengths of the nine sentences -21, 22, 22, 11, 16, 23, 14, 23, and finally 49-certainly produce an impression of monotony. In the paper beginning on page 228 of the same issue of the Journal the word-lengths of paragraphs 2 to 8, totalling 512 words, are as follows: 71, 80, 65, 75, 57, 81, 73. In neither instance, probably, was the writer at all aware of any suggestion of monotony in his presentation. There are similar passages elsewhere in the year's issues of the two magazines.

On the other hand, sometimes there will be surprising irregularity in length or emphasis of paragraphs. In a very interesting paper beginning on page 108 of the Journal of Accountancy for February, 1948, the length in lines of paragraphs 11 to 17, totalling 700 words, varies greatly, as follows: 4 lines; 37 lines; 32 lines (not counting 14 lines of a quotation); 4 lines; 5 lines (not counting a 17-line quotation); 4 lines; 20 lines. Paragraph 22 fills 63 lines, of which 46 lines are quoted material. Such unevenness of paragraph-length is likely to seem queer to readers. What to do when one's discussion must include quoted material of varying length is not easy to determine. It may be wise to set all quotations in smaller type or in narrower measure. In any event one needs to bear in mind that marked unevenness of appearance is likely to seem clumsy, and in consequence hinder swift and satisfied grasp of what the writer has to say.

Both these major difficulties relating to paragraph structure would seem to

stem from the same cause, namely, the writer's failure to make full allowance for the impact of his thought, and his manner of expression upon the reader -whether upon the reader's logical sense or merely his sense of sight. Adjusting the manuscript to remove such defects goes far toward warding off possible suggestions of clumsiness. To consider merely words and sentences may not suffice to reveal such awkward spots. Constant care for well-balanced paragraphing shows where they are and indicates what to do about them.

It is wise, also, to watch one's step throughout an article. The paper on Cost Accounting principles in the December issue of this magazine illustrates this point. The first two-thirds of that paper, through paragraph 28, are virtually perfect with respect to clarity and precision of presentation. Certainly the handling of paragraphs, both individually and in their linking into sectional groups, is a remarkably skillful piece of rhetorical architecture. But the last third of the paper, from paragraph 29 onward, is a different affair. To plot the 'line-of-march' of those later paragraphs is difficult indeed. One wonders what happened in the course of production of this most interesting article.

Among the papers published last year in these two magazines there are some in which the requirements of good paragraph technique are satisfactorily maintained throughout. At the risk of invidiousness may I mention the paper in the New York Certified Public Accountant for February, 1948, beginning at page 93. Incidentally, this was another tax lecture. I know nothing about the writer, and certainly I have no knowledge of the matter which he discusses. The paper fills 720 lines -about 4700 words. Subtracting 78 lines of quoted material, we have 43 paragraphs, averaging 97 words in length, and 137 sentences, with an average sentence length of 30 words long sentences! But reading the paper aloud-and it was manifestly meant to be listened to, not merely perused visually-reveals its directness, variety, and balance. I should guess that the writer has had considerable experience before audiences. Which suggests a final reflection, regarding the clumsiness that my accountant friend found in memorandums and professional papers: Perhaps much of what troubles him might disappear if writers were always to test their copy by reading it over, aloud, before releasing it-with special attention to the paragraphing.

#### AN ADIRONDACK VIEW

The Dodgers vs. the I. U. Some game! And part of it was played in Brooklyn. But not in Ebbets Field. We are not talking about baseball. Believe it or not we are reviewing a book. I. U., in this alphabetic era, is the Intelligence Unit of the Enforcement Branch, U. S. Treasury Department. The book is "The Tax Dodgers," by Elmer Irey as told to William Slocum.

Irey really did some telling. He laid it right out on the table, told their names and what they did and said. United States Presidents were not excluded. One name, only, is footnoted as fictitious.

There is no index. The book is not built to be a reference inmate of your tax library. It is not a put-me-to-sleep book either. It is a forget-the-cares-of-the-day book. As soon as you start to read it you forget everything and the next thing you know it's the next chapter. Then you are lead into temptation: you want to keep right on reading, regardless of what the alarm clock says and regardless of those million-dollar problems to be solved tomorrow. It's a crime story-murder, stick-ups, women, thugs, everything, including the successful detection of the culprits and their unhappy ending.

Slocum wrote it in a smooth, fast-reading style. The tax-fact on which the book is based is-no matter how illegal the income, it is taxable just the same. Read all about it!

LEONARD HOUGHTON, C.P.A.

Of the Adirondack "Chapter"

# Other Aspects of the Capital Recovery Problem

By Louis Roth, C.P.A.

# Victims of Inflation

The shrinking value of the dollar has caused hardship in many areas of our economy and has evoked various measures to mitigate the hardship. In general, the measures proposed and put into effect in many fields of endeavor have been to supply more dollars to raise the shrunken purchasing power of the recipients of the dollars. That palliative has been helpful in varying degrees to those selling goods, labor and services, but has left out of consideration many millions who have not been supplied additional dollars for their needs. These constitute the recipients of social security, of retirement pensions, of fixed income rate on investments and savings, such as preferred stock and bonds, of interest in savings banks, and of life insurance annuities. Their complaint has been of long standing but no one has proposed to expand their income except as to those receiving social security, whose frozen meager allotments may perhaps be thawed out and enlarged if President Truman's campaign promise should be enacted into law. The others will remain the innocent victims of inflation unless and until a radical deflation or depression should set in, which would, of course, injure many more than it would relieve.

# Adjusted Depreciation

Accountants who are not conversant with economic theory consider the evil effects of inflation from the limited viewpoint of the declining value of fixed assets and inventory and their effect only upon equity investment in business. With a view of safeguarding the value of such equity investment they have revised with government consent the pricing cost of sales and balance sheet inventories from fifo\* to lifo,\*\* and they have given thought to changing depreciation charges from investment cost to replacement cost basis not, however, approved by the government.

Both changes, that of inventory and that of depreciation, have been treated at length by H. T. McAnly, C.P.A., in an essay on Curbing the Effect of our Erratic Dollar in Pricing Inventories and Providing for Depreciation, which appeared in the New York Certified Puble Accountant, issue of August 1948, pp. 573-82. The author of this essay is apparently not aware of the inherent problems involved in the second part of his thesis, depreciation charges. Attention is therefore directed mainly to that part (II), depreciable fixed assets (p. 578), with reference,

This article brings to the forefront other aspects of the capital recovery problem produced by inflation.

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Dr. Roth was, for many years, associated with The New York State Public Service Commission. He is an accounting expert in the valuation of public utility properties for tax purposes. He is now engaged in public practice on his own account.

<sup>\*-&</sup>quot;first in first out"
\*\*-"last in first out"

however, "to all equity capital invested in the business, both working capital and investment in fixed assets" (p. 573). As to depreciation, McAnly would, as already indicated, "provide for accrued depreciation adjusted to give effect to changes in the purchasing power of the dollar" (p. 579). In other words, he would accumulate in the depreciation reserve an amount equal not only to the original cost of the fully depreciated fixed asset but an amount which would equal its replacement cost. To be consistent, however, he adds that in a period of declining price level he would likewise accumulate only an amount equal to the replacement cost of the fixed asset.

# Continuity of Efficiency Preserved

Accounting treatment of depreciation charges, as above recommended by McAnly, is surely equitable to the stockholder and, even if all the profits thus determined were distributed in dividends, it would still insure the continuity of the efficiency of the enterprise provided by their investment. It implies that as the stockholders, let us say, provided fixed assets of a certain quantity or quality, whatever the cost may be, they should always have in the enterprise fixed assets of the same quantity or quality, or the equivalent money value thereof, whatever the cost may be. If the cost of the original unit were \$1,000 with a useful life of ten years, and the estimated replacement cost at the end of ten years were to be found after five years' use to be \$2,000, then, if no salvage value be assumed, the depreciation charges should be adjusted so that at the end of ten years the accumulated reserve would be \$2,000. If on the other hand, it be estimated at the end of five years' life that the replacement cost at the end of ten years would be only \$500 and that \$500 had already been accumulated in the reserve, then either no more depreciation charge should be made or, with due regard to non-modification for income tax purposes, \$250 would be returned to Surplus and that depreciation charge should be continued for the remaining five years. These are extreme examples given by me as simple illustrations only of the portent of McAnly's dissertation,

# Inapplicability of General Price Index

The foregoing treatment assumes either that the amount of advance or decline in prices would be determined for the particular depreciable fixed asset or that the general price index would be made applicable to it. If the latter, then it may prove to be inequitable, as there may be considerably greater variation in the price rise or fall of the particular fixed asset than in the prices of other commodities or in a general price index.

# Accountants' Committee for Depreciation on Cost Basis

There are, however, much greater problems inherent in this desire to do justice to the owner of equity capital invested in business through adjusted depreciation charges. The difficult problems involved were sensed, no doubt, by the majority of the committee on accounting and procedure of the American Institute of Accountants as reported in the Journal of Accountancy, issue of November, 1948 (p. 380), which on October 6, 1948 decided, with four members dissenting, not to deviate from Accounting Research Bulletin No. 33 (December 1947), which recommended that income continue to be determined on the basis of depreciation on cost. But in the words of the editor (p. 353), "the committee does recommend that stockholders, employees, and the general public be informed that a business must be able to retain out of profits amounts sufficient to replace productive facilities at current prices.'

# Refund of Equal Purchasing Power to All Investors

With due respect to the pronouncement of the Committee's report, never-

theless, the effort to change from the old method to a more equitable treatment of investors is commendable. But equity should extend to all investors, not only to common stockholders. Why discriminate against preferred stockholders or against bondholders? Their money, as well as that of the common stockholders, may have gone into the purchase of fixed assets. The fixed assets are more likely represented by fixed liabilities to investors in preferred stocks or bonds than to equity investors in common stock. But even regardless of the character of the investments as to length of life expectancy, it is only fair to return to them at least the equivalent in value or purchasing power of the amount of money or purchasing power invested by them.

# Refund of Equivalent Capital of Predominant Importance

An assurance of the refund of the equivalent of the investment is far more important than a payment of interest or dividend on the investment, as the investment of capital represents in the traditional economic parlance saving or sacrifice, while the return on investment of interest or dividend represents only unearned income. Care must be had, therefore, to keep low the interest and dividend payments in order to safeguard the undiminished value of the capital investment. That a guarantee of reimbursement of equivalent in value of capital investment at a low rate of income return would not fail to attract capital is evidenced by the very low rate of return at which long-term bonds are floated even now, when only the nominal amount of dollars is guaranteed to be refunded. The oft-repeated assertion that business enterprises would not expand without high rate profit inducements offered to risk or equity capital has no validity whatever, as savings to be retained must be invested, otherwise they would lose their existence, for the people's savings are imbedded mainly in goods and not in money. The wealth of the world consists of commodities of which money, even money made of precious metals, represents but a very small part, and paper money has no value at all except as representative of hard money or other commodities. Moreover, more people save for emergency, sickness and old age, than for income. Wisdom dictates savings for such purposes, as without savings there would be no accumulation of capital, in fact no comforts of civilization at all, and life itself would be of much shorter duration.

Squirrels, bees and ants store up provisions for the winter. Do we not expect human beings to make provision for the winter of their lives? The fact is that they do so, even though they forsee loss of some of their savings by

depreciation in value.

Since the necessity of savings for the purposes set forth has been so universally recognized from time immemorial, is it not also very important that safeguards be provided so as to permit that the reimbursement of the savings to be used for such purposes be of at least the same value as when the savings were set aside with a view to future use? Corporations should maintain, with the proper advice and assistance of economists and accountants and with government tax-exemption guarantees, stabilized purchasing power values of all stocks and bonds. Assisting corporations so to do, the government should, of course, guarantee stability of purchasing power of its own bonds, especially its savings bonds and of savings in federal banks and federal savings and loan associations.

# Equity, the Guiding Rule of Conduct

Three highly intelligent laymen with whom I have discussed the matter all remarked, "What would you do in times of considerable price decline and the rise in the value of money? Would you apply the same rule of reimbursement of purchase power with a reduced nominal amount?" My answer is emphatically, "Yes."

Serious price decline and rise in the value of money happens only infrequently, during abnormal conditions, but the normal state is for prices to advance gradually and for the money value gradually to decline. During my college vears as a student of economics, I read Six Centuries of Work and Wages by a noted British economist, Sir Thorold Rogers, who gave prolific statistical data to show how progressively during all that long period prices and wages in England rose and money declined in value. The economic history of our own country fully substantiates the conclusion reached that the changing scale of prices is upward and of the value of money is downward.

If justice be done to investors, the same rule of justice should apply in all cases. As no loss should be suffered by investors when their investments depreciate in value, so consistent-wise no gain or advantage should be had by investors when the investments appreciate in value. These remarks made relative to the maintenance at intrinsic par value of investments are, of course, apart from consideration of interest or dividend payments on or accretions added to the investment for interest and dividend.

It may be said that the effectuation of such principles of equity would be difficult indeed. Admitted, but if principles of equity are to be, as they should be, a guide to business' political and social conduct, ways will be found to put them into effect.

# Limited Income Distribution and Tax Application

A guaranty of refund of equivalent investment value, necessitating greater conservation of profits and limited distribution of spendable investment income dollars, would limit money circulation and prevent or check inflation. Corporations could make such provisions without government interference, however, only if section 102 of the tax law were repealed, for this section still places a heavy penalty (271/2% to 381/2%) on unreasonably accumulated income of corporations. If section 102 were repealed, in compliance with the one-time almost unanimous corporate demand that it should be repealed, or even if the repeal should now be considered unnecessary because it is not equivalent enforced, consideration should be given to partnerships and to individual ownerships, which should likewise be entitled to accumulate, taxexempt or tax-reduced, a certain portion of the profits of the business for expansion, which is required by them as well as by corporations. And in view thereof, and even for more cogent reasons, individuals in or out of business should have an exemption of at least the minimum of subsistence which is fundamentally the same for all, except by reason of the presently recognized variations due to number of dependents, sickness and old age.



# New York State Tax Clinic

Conducted by BENJAMIN HARROW, C.P.A.

# Deduction for Life Insurance Premiums

Such expenditures are deductible from gross income in an amount not exceeding one hundred fifty dollars. (Sec. 360.16) On a joint return, however, this expenditure is allowed for both husband and wife. The total deduction on a joint return could therefore be \$300. In a question and answer release of the Tax Commission under date of March 18, 1943, this interpretation is indicated in question 24. The husband paid \$200 for life insurance premiums and the wife \$100. The deduction allowed is \$150 (the maximum amount allowed) for the husband and \$100 for the wife. If the husband paid \$500 for premiums and the wife carried no insurance the total deduction on a joint return would be only \$150 (Question 25). Premiums paid would be the net premiums after dividends, if the latter are applied against the pre-

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mium. (Question 27) Nonresidents are not allowed to take this deduction since such payments are not connected with income arising from sources within New York (Question 29).

# Deduction for Federal Excise Taxes

A taxpayer pays a federal excise tax of \$125 on the purchase of a fur coat. Is this deductible from gross income? Taxes imposed by the United States, any state or taxing subdivision of a state, or by any foreign government are deductible from gross income. Specifically excepted are inheritance taxes, gift taxes, and income taxes. The Regulations add that taxes upon sales, services or facilities are not deductible unless under the provisions of the particular taxing statutes the tax is expressly imposed against the taxpayer. The federal excise tax on furs is imposed against the manufacturer and not against the taxpayer. Hence it is not deductible by the taxpayer.

# Some Other Aspects of the Deduction for Taxes

The Regulations (Art. 141) provide that in connection with the ownership of property, taxes paid are not deductible if current income from the property is not includible in gross income.

Stock transfer taxes, both federal and state, are deductible but only in computing capital gain or capital loss. Under federal law, federal stock transfer taxes are not deductible as taxes but are considered in determining the net selling price of securities. The state stock transfer tax however is deductible as a tax under federal law.

Postage is not considered to be a tax. Automobile license fees are deductible as taxes. A tenant-stockholder of a cooperative apartment corporation may deduct payments made by him representing taxes paid or incurred by the corporation.

The Canadian tax on dividends from Canadian corporations paid by non-residents of Canada is not deductible. The New York resident is taxable on the gross dividend without deduction for the Canadian tax.

Cigarette taxes levied by the State and City of New York are assessed against the dealer and only he may take this deduction.

The New York City Sales tax is deductible by the purchaser who pays the tax and against whom the tax is assessed.

Water "taxes" are not considered to be taxes, and hence are personal expenditures and not deductible. The federal rule is the same.

# Franchise Tax—Definition of Corporation

While the franchise tax applies principally to corporations, the word corporation is defined in the law and in the regulations to include other entities that conduct business in the manner that a true corporation does. Thus a joint stock company or association is taxable as a corporation. So also is "any business conducted by a trustee or trustees wherein interest or ownership is evidenced by certificate or other written instrument."

Under the latter section of the law the Tax Commission attempted to impose the franchise tax upon an investment trust created by six members of a family. Two of the members acted as trustees. They managed the properties and paid over the income. The trust was to continue for the lives of the original trustees. The beneficial interests of the members was to be divided into shares and every shareholder was entitled to receive a prescribed certificate indicating his interest in the trust. While the certificates had been drawn, actually they had never been delivered.

The trustees had broad powers to deal with the principal of the trust, although those powers were never emploved by the trustees. What they actually did was to collect and distribute the income each month. Securities were generally held to maturity. During the period of the eleven years that were in issue before the Appellate Division, there were only twenty transactions involving the sale of securities before maturity and sixty-five purchases of bonds. On the basis of the actual activities of the trustees the Court concluded that the transactions comprised the investment and reinvestment of principal for the purpose of obtaining income. They did not indicate the conduct of a business in buying and selling securities for speculative profits.

The Court held that the trust was not carrying on a business subject to tax under Article 9-A. The organization of the trust brought it within the definition of "corporation" but the issue was whether the trustees were engaged in business. Mere investment of funds and collection of income with incidental replacement of securities and reinvestment of funds do not constitute a business and do not bring such activities within the taxing statutes. The Court also says that the test of the trustees' activities is what they actually did and not what they might have done, under the broad powers they had. This case was decided on November 10, 1948. (Matter of Burrell et al. v. Lynch et al., App. Div., Third Dept.)

In 1941, the United States Supreme Court had occasion to rule on the question of the deductibility of expenses in connection with the trading activities of a taxpayer in the securities markets. It held that such activities did not constitute a trade or business and hence disallowed the deductions. It was that decision which led Congress to enact

<sup>1</sup> Higgins v. Commissioner, 312 United States 212.

Sec. 22(a)(2) of Internal Revenue Code, which now allows as a deduction expenses incurred in connection with the production of income even though such activities do not constitute a trade or business. The *Burrell* case apparently follows the Supreme Court in distinguishing business activities and investment activities.

# Compensating Use Tax

A New York City vendor sells tangible personal property to a New York City customer. Delivery is made from an out-of-city point where the customer takes delivery. The vendor has no control over or knowledge of the eventual destination of the goods. Under these facts the vendor is not required to charge and collect the tax but he must obtain a signed statement from the customer certifying that after taking delivery at the out-of-city point, the customer has arranged for its transportation to a destination that is outside the City of New York. If the New York City customer subsequently uses the property in the City of New York he is required to pay the tax directly to the city. Such a certificate is not to be accepted from the New York City customer who arranges for the transportation of the property to a New York City destination. In such a case the vendor must charge and collect the Compensating Use Tax. This is the substance of a ruling of the Special Deputy Comptroller, dated November 5, 1948.

## Gross Receipts Tax

This is a New York City tax on the privilege of doing business in the city. If a corporation ceases active business operations and starts liquidating its business, it is still carrying on a taxable activity. Art. 109 of the regulations provides that the gross receipts or gross income, as the case may be, resulting from operations carried on during the period of liquidation are to be included in the measure of tax, under the provisions of the General Business

and Financial Tax Law. The privilege period upon which the tax is based commences July 1st. The corporation can save the gross receipts tax for the privilege period beginning July 1st by turning over to another person or organization the collection of outstanding accounts if liquidation is not completed by June 30 of any year.

# Withholding Tax on Nonresidents

The personal income tax law requires an employer to withhold the tax on a nonresident's income. This provision in the law (Sec. 366.1) is often overlooked by close corporations where one of the officers is a nonresident. The corporation may be subject to penalties for non-compliance with this provision. In case of failure to withhold, the withholding agent is responsible for the tax should the employee fail to pay. Moreover, for failure to withhold, file a return, or to pay a tax, the withholding agent may be subjected to a civil penalty of \$500.

By March 1, 1949, the corporation or any other employer should file form 105 and 106 and remit the tax to the State Tax Commission. The employeeofficer will, of course, take a credit for the tax withheld in filing his nonresident return. (Form 203). As the law stands presently the employer should withhold only 50% of the normal tax due on all payments in excess of the personal exemption and standard deduction of the nonresident employee. The employer need not take into account the 10% war bonus tax unless the employee consents to this additional withholding.

According to Art. 265 of the regulations if a nonresident receives compensation for personal services performed both within and without the State, the employer withholds the tax only on the portion of the compensation earned within the State. Such earnings are determined on the basis of an apportionment. This may depend upon the ratio of the volume of business done in New

(Continued on page 200)

# Accounting at the S. E. C.

Conducted by WILLIAM W. WERNTZ

# Profits and surplus

In two releases dated December 21, 1948, and February 4, 1949, S.E.C. published statistical data as to two groups comprising 548 registrants filing under the 1934 Act that could provide considerable food for thought for those interested in the role played by general reserves and by surplus charges and credits in current accounting practice. In recent years, a good deal of attention has been given to what has been termed "the sharpening of the annual income statement" through exclusion therefrom of those charges and credits which fall broadly into one of two general categories: First, those which do not reflect any current, realized and recognizable profits or losses but, instead, represent some sort of estimate of future losses, or a general contingency provision; and second, those items which represent actual profits or losses but which are clearly not applicable to operations of the current year, and are so large in amount as to distort income if included therein.

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Mr. Werntz is a graduate of Yale University and of Yale Law School, and is a member of the Connecticut Bar. He was formerly an instructor of accounting at Yale University and Yale Law School. He was also an accounting consultant to the O.P.A. and the Treasury Department.

Mr. Werntz is the author of numerous articles which have appeared in technical accounting publications.

The releases, which are based on S.E.C.'s Survey of Listed Corporations, summarize data as to the following major industry groups: Ferrous and non-ferrous metals; transportation equipment; machinery (parts and equipment); oil refining; and rubber products. The companies included reported for 1947 net sales of \$44.2 billions and net profits after taxes of \$3.5 billions. Of course, such statistical summaries cannot reflect the reasons why an individual company may have chosen the particular presentation, nor can such summaries be treated as reflecting a sort of average company or indicating what can be expected to be found in any single company. They do, however, give, it seems to us, a kind of composite picture of what the consumer of financial statements has to face when he seeks to understand and relate or compare the practices of several companies in which he may be interested. Besides illustrating the variety of prevalent practices, the tables raise two other points of special interest. First, they illustrate quite clearly a substantial change in practice between 1946 and 1947. Second, solution of some of the income statement problems by the transfer to surplus of both types of items mentioned above may pose to the reader a problem in analysis of surplus items, at least partly comparable to what theretofore was a problem of income statement analysis; the area of doubt is transferred to surplus to be sure, but unless the surplus items are grouped and clearly described and characterized, the possibility of confusion still remains.

In the interests of space economy, tables shown in the two releases are combined below:

## "SUMMARY

OF

Reserves for General Contingencies, etc.
Reserves for Future Price Decline in Inventories
Reserves to Provide for Replacement of Plant Facilities
Reserves for Excess of Current Construction Cost over an Estimated
'Normal' or 'Reasonable' Level of Costs
Reserves for General Contingencies, etc. No Longer Required

(Thousands of Dollars)

	171 Registrants				1947 172 Registrants			
	Reported in P. & L. No. of Co's. Amount		Reported in Surplus No. of Co's. Amount		Reported in P. & L. No. of Co's. Amount		Reported in Surplus No. of Co's, Amount	
Reserves for general contin-		ramount	CO 3.	Amount	CO 3.	Amount	CO S.	Amount
gencies, etc.	28	\$12,355	20	\$ 63,544	12	\$ 5,056	33	\$ 37,553
Reserves for future price decline in inventories	13	8.733	9	3,165	9	1,950	37	37,080
Reserves to provide for re-								
placement of plant facilities	1	385	3	2,020	2	1,349	12	12,570
Reserves for excess of cur- rent construction cost over an estimated 'normal' or 'reasonable' level of costs	0	_	0	- Children	3	7.650	3	8,650
Reserves for general contin- gencies, etc. no longer re- quired credited to P. & L.						7,000		0,000
or Surplus	23	14,868	95	234,394	7	14,010	73	122,562"

In the table, S.E.C. grouped as "surplus" items not only direct surplus charges and credits but also items reported by registrants as "appropriations" of net income and reversal of reserves added to net income. In view of recent A.I.A. bulletins on the sub-

ject, it is unfortunate that these latter two classes are not separately shown.

Of almost equal interest and germane to the same point is the following combined table summarizing the amounts, nature and location of items affecting income taxes as reported by the same group of registrants:

#### "COMPOSITION OF PROVISION FOR INCOME TAXES

(Thousands of dollars)

	19	146		1947	
Provision for current year's taxes  Less: 'Carry-back' refunds  Refunds and adjustments applicable to prior years  Plus: Adjustments applicable to prior years	\$429,327 15,846 10,271	\$958,250	\$126,216 7,438 3,962	\$2,070,079	
Net tax adjustments		(434,902)		(129,692)	
Net tax deduction reflected in the P. & L. statement		\$523,348*		\$1,940,387	

	1946	1947
Tax adjustments other than in P. & L. statement:		
Credits:		
'Carry-back' refunds credited to Surplus	\$ 3,607	\$ 1,737
Tax refunds and adjustments credited to		
Surplus	18,444	13,908
Tax refunds and adjustments credited to Reserves for Contingencies, etc	18,378	16,557
Tax refund off-set against accelerated amortization of emergency facilities	736	deletion.
Debits:		
Tax adjustments charged to Surplus	20,301	11,654
Tax adjustments charged to Reserves for Contingencies, etc	10,197	15,837

<sup>\*</sup> Includes provision for renegotiations (amount not stated) reported by one registrant."

The full reports give this data by companies and groups. Most unfortunately, the two releases carry the note that copies of the full report were not prepared for general distribution because of budgetary limitations. They

may, however, be inspected at any office of the Commission and at selected depositary libraries, and photo copies of all or parts of them can be secured on payment of standard fees.

# New York State Tax Clinic

(Continued from page 197)

York to the total business, if the compensation of the nonresident is on a commission basis. Otherwise, the apportionment is made on the basis of the ratio of the total number of working days in the State to the number of working days within and without the State.

Art. 261 has recently been amended (Jan. 13, 1949) and provides that no withholding is required on payments of less than \$1,100 to a single person or \$2,750 to a head of a family or a married person.

# Deduction for Additional Franchise Tax Assessment

Because of the new franchise tax law enacted in 1944, and the different provisions in the old and new laws governing the deductibility of the franchise tax, there has been some uncertainty as to when an additional franchise tax assessed for a privilege period begun before Nov. 1, 1944, was deductible. Under date of January 9, 1949, Deputy Commissioner Kassell issued an opinion on this question. If the additional franchise tax is imposed under old Art. 9A, it is deductible in the same period as allowed for federal income tax purposes. Under new Article 9A, the deduction is allowed on the report covering the period immediately following that upon which the additional tax was based.

When new Art. 9A was enacted, there was included a provision that "all the provisions of article 9A" \* \* \* heretofore in effect \* \* \* shall continue in effect with respect to" taxes due for any privilege year beginning prior to November 1, 1944. The provision in new article 9A with respect to the year of deduction for the franchise tax was not contained in the old law and therefore the old law still applies in the case of a deduction for a franchise tax computed under the former statute.

# COMMITTEE ACTIVITIES

# COMMITTEE ON STATE TAXATION

On December 7, 1948, the Committee on State Taxation conducted the first of its technical meetings this year. Following its successful effort last year, a panel of tax men, drawn from the committee, discussed the answers to the questions which they had previously submitted. The questions appeared in the December issue of *The New York Certified Public Accountant*, on pages 923 and 924.

The latter part of the meeting was devoted to a question and answer period, and the active participation by the audience was indeed a tribute to the members of the panel for their untiring efforts in arranging the meeting.

The questions covered the New York State Income and Unincorporated Business Tax and the Franchise Tax on Real Estate Corporations. The solutions to them appear below.

Frank E. Knopf, Chairman Sub-committee on special meetings

# Group I-Optional Deduction

Answer to Question 1

The amount of the optional deduction, in place of all other deductions, is \$500 or 10% of gross income, whichever is less. A husband and wife living together may elect to claim the optional deduction but it is not allowable unless both claim such deduction, either in joint or separate returns. If separate returns are filed, the optional deduction may be claimed by either or divided between them, as they may choose. The total amount claimed by husband and wife in either a joint or separate return may not exceed 10% of their aggregate gross income or \$500, whichever is less.

Answer to Question 2

Any election to use the optional deduction is irrevocable with respect to the taxable year in which it is used.

Answer to Question 3

Yes. In those cases where his detailed deductions allocated to New York State income

do not exceed 10% of New York State gross income or \$500, whichever is less. Furthermore, if the optional deduction is taken, it is not necessary to show that it is related to income earned in New York State.

Answer to Question 4

No. In addition to those items, it covers expenses paid in connection with earning compensation, contributions, extraordinary medical expenses, other business deductions (Schedule A), and depreciation, repairs and other expenses connected with the operation of rented property (Schedule B). In other words, the taxpayer should compare the amount of the optional deduction with the total specific deductions described above, in order to decide which is more advantageous.

Answer to Question 5

Separate returns should be filed. In John Doe's return he should claim the optional deduction of \$500 and no deduction should be claimed in the separate return of Mary Doe. Although the optional deduction of \$500 is less than the total specific deductions of \$800, nevertheless, the combined tax is less when the \$500 deduction is taken at the higher rates imposed on John Doe than the saving on the \$700 at the lower rates for Mary Doe.

Answer to Question 6

The specific deductions of \$800 under Item 21(d) exceed the \$500 limitation of the optional deduction. Accordingly, the specific deduction, as well as any other allowable deductions, should be claimed. In this respect the federal law differs from the New York State law in that the taxpayer would be allowed the \$500 deduction in arriving at his adjusted gross income as well as the standard deduction.

HAROLD E. BISCHOFF, C.P.A.

# Group II—Problems Affecting Estates and Trusts

There are two aspects to the question: first, the fiduciary accounting point and, second, the New York State income tax prob-

The fiduciary accounting question should be answered, perhaps, by the Committee on Fiduciary Accounting, and in practice by the attorneys of the estate. In the preamble to the question, the answer of the attorneys is presented. It is amplified by the five questions and may be expanded somewhat as follows:

As to item (b), charging income for interest from date of death through the fiscal year in which dividends received exceeded the interest charge, it appears that the charge to income should be for interest at a rate not exceeding the rate of earnings by the corpus. Furthermore, while there is logic to the view that by deferring the payment of the balance of gift tax, corpus was retained and income derived therefrom, it should also be noted that the delay in payment resulted from contesting the valuation of the subject of the gift-a contest which was conducted for the benefit of corpus. Also, the executrixlife-tenant deferred paying herself fees as executrix, pending settlement of the case, thus leaving securities in the hands of corpus.

As to item (c), the charge to corpus during the period when there was no income may be considered a temporary charge until there is income out of which to reimburse corpus for the interest charge advanced, or until the executrix reimburses corpus out of her own funds, should that be decided upon or should it be the subject of a surcharge by the surrogate.

On the other hand, bearing in mind all of the equities of the case, including those discussed under item (b) above, and including the expressed intention of the testator that his widow be provided for, it may be decided to charge to corpus the entire amount of interest paid, leaving the Surrogate to rule to the contrary, if he should disapprove the course taken.

Turning to the tax questions proper, there are two parts to be considered: the treatment of the charge in the fiduciary return and the deductibility in the personal return of the life-tenant.

The amounts charged to corpus may be deducted on the fiduciary return, but inasmuch as there are no taxable receipts by corpus, except from capital gains, the deduction is without effect because the item of interest paid cannot be classified as a capital deduction applicable to capital gains.

The amounts charged to income are deductible in the determination of net income distributable and taxable to the life-tenant. There is no problem here except as to item (c), if alternatively it is charged to income and thus creates a debit balance. In that event it is not believed the life-tenant can take the item as a deduction on her personal return until she reimburses the estate either voluntarily or after being surcharged. Indirectly she would receive the benefit of the deduction when and if the debit balance were applied as an offset to subsequent income.

I. B. C. Woods, C.P.A.

# Group III—Ordinary Deductions— Difference in Treatment for State and Federal Tax Purposes

# Answer to Question 1

Taxpayers married February 14, 1948: Section 362 of the Tax Law provides that if the status of the taxpayer changes during the year, such exemptions shall be apportioned in accordance with the number of months before and after such change.

Under federal law, the determination of whether a person is married or single is made as of the last day of the taxable year, and no proration is required. The death of either spouse during the year 1948, however, does not preclude the survivor from filing a joint return and enjoying the advantages of the current income-splitting provisions.

# Answer to Question 2

Medical expenses—\$6,000: Under federal law, on a joint return with four exemptions, the maximum deduction is \$5,000 for medical expenses. The deduction is allowed to the extent that expenses exceed 5% of adjusted gross income.

The maximum state deduction allowable for medical expenses in any one taxable year is \$1,500 in the case of a head of a family or on a joint return. In all other cases, the maximum is \$750.

## Answer to Question 3

Life insurance premiums—\$500: Deductions can be made for premiums paid or incurred during the taxable year with respect to any life insurance or endowment policy upon the life of the taxpayer in an amount, not exceeding, in the aggregate, \$150. Premiums on insurance covering the life of dependents are not deductible. The cost of a straight annuity contract is not deductible.

On the taxpayer's federal return, no deduction for life insurance premiums paid is permitted.

#### Answer to Question 4

Interest on U. S. Treasury Bonds, and bond premium paid: The New York tax law excludes from gross income, interest on the obligations of the United States or its possessions. The premium affects the basis for determining subsequent gain or loss on the sale or redemption of the bonds.

Under federal statute, if income from bonds is fully taxable, amortization is elective.

#### Answer to Ouestion 5

Interest on City of New York Bonds: Interest received is taxable, except in so far as specifically exempted by law. Among items exempt from taxation is interest on obliga-

tions of New York municipalities and political subdivisions.

Under federal law, interest on obligations of a state, territory, or any political subdivision thereof, is exempt from income tax.

# Answer to Question 6

Federal excise taxes (non-business): Article 141 of the State Regulations provides that only taxes expressly imposed against the taxpayer, under the provisions of a tax statute, are deductible by such taxpayer.

Federal taxes which are not deductible, when paid as personal expenses, include the tax on admissions, dues, firearms, safe deposit boxes, stamp tax, telephone, telegraph and cable, transportation of persons, and transportation of property.

# Answer to Question 7

Child born December 15, 1948: Section 362 provides for proration in case of change of status. The taxpayer would be entitled to a credit for the dependent of 1/12 of \$400 or \$33,33.

Under federal law, there is no proration and a credit for the dependent of \$600 would be deductible.

# Answer to Question 8

Commission for long-term services: On the taxpayer's federal return, he would be entitled to compute his tax under I.R.C. Sec. 107 (a) provided he met the requirements as to the length of time from beginning to completion of his services, and percentage of total compensation received in the taxable year.

New York State has no similar provision.

#### Answer to Question 9

New York State income tax paid: Income taxes are not deductible. The item of \$850 cannot be taken as a deduction on the 1948 state tax return.

On the taxpayer's federal return, the \$850 would be deducted as a tax paid.

ROBERT I. EDELSON, C.P.A.

# Group IV—Capital Gains and Losses

These questions are designed to raise, and settle to a certain extent, the question of the differences between the federal and New York treatment of capital gains and losses. We are much too prone to assume that the rule for New York State tax purposes. This is definitely not so. The problems are intended to indicate the following specific differences:

(a) There may have been a wash sale of the ABC Corporation's stock in some prior period. The loss resulting from this sale would not have been deductible for federal purposes, but would have been deductible for New York State income tax purposes in the year of the loss. Even if the former loss was not a bona-fide loss the basis of the stock repurchased would not be affected by the previous transactions. The loss in the year 1948 would therefore be less than the federal loss by the amount of the loss previously reported.

(b) The fact that this year's return shows no dividends from the PDQ Corporation would lead the tax preparer to suspect that it might have been sold. Investigation might indicate that it had been sold to taxpayer's brother and that as a result of the provisions of Section 24 of the Internal Revenue Code the loss had not been deducted on the federal return. Since New York has no equivalent provision, if the sale was a bona-fide one the loss is fully deductible.

(c) The fact that taxpayer has moved and that his real estate tax and mortgage interest have decreased should lead to an investigation which might reveal that taxpayer had sold his former home at a loss. This is a personal item under the federal law and therefore non-deductible, but under the New York State law the amount is fully deductible against capital gains.

The New York State tax on capital gains might be summarized as a separate tax not a part of the income tax, although it is filed on the same return and certain of the rules are applicable to both. It is a tax on capital gains less capital losses less "capital deductions" and less any personal exemption which may not have been consumed for ordinary tax purposes. The rates are one-half of the rates applicable to ordinary income. What constitutes a capital gain or loss is very similar to what constitutes a capital gain or loss under the federal laws, except that all losses are deductible since there is no limita-tion on personal losses. The excess of losses over gains may be carried over for five years without any limitation. Unlike the federal treatment, there is no \$1,000 a year limitation since no capital losses are deductible from ordinary income.

RALPH G. LEDLEY, C.P.A.

# Group V—Unincorporated Business Tax

The Unincorporated Business Income Tax is levied upon the New York net income of individuals and partnerships, and is in addition to any personal income tax which such persons may pay. The tax applies to any legal entity other than one subject to Corporate Franchise Tax.

Section 386 of the New York Tax Law provides that the words "unincorporated business" exclude the practice of law, medicine, dentistry, architecture, and any other case in which more than 80% of the gross income is derived from the personal services actually rendered by the individual or the members of the partnership or other entity in the practice of any other profession and in which capital is not a material income

producing factor.

A return must be filed by every unincorporated business having either a taxable income, that is, a net income in excess of the exemption allowable which is \$5,000 or a gross income in excess of \$10,000. The permanent rate of tax is 4%, but has been reduced by legislative amendment in recent years to 3%. The rate for the year ended December 31, 1948, has not as yet been established.

# Answer to Question 1

Let us first see what the statute calls a profession. In general, it may be said that

"... a profession includes any occupation or vocation in which a professed knowledge of some department of science or learning is used by its practical application to the affairs of others, either advising, guiding or teaching them, and in serving their interests or welfare in the practice of an art founded on it. The word implies attainments in professional knowledge, as distinguished from mere skill, and the application of such knowledge to uses for others as a vocation."

The State Tax Commission recognizes optometry as a profession. However, in the case of an optometrist there is a problem of segregating his income into those charges which are purely for professional services as distinguished from receipts from the sale of merchandise. If the charges for purely professional services can be identified and are segregated, this income less applicable expenses would not be subject to tax. If the professional income cannot be segregated, then the entire receipts of the profession and business combined would be taxable.

Therefore, the answer to Question 1 would be that all New York income would be subject to the Unincorporated Business Tax except that portion definitely attributed to pro-

fessional services.

## Answer to Question 2

The unincorporated business is subject to the tax on only that portion of the income attributable to New York State. Net income from sources within this state should be determined as follows:

(a) If the books of the unincorporated business are so kept as to disclose the proportion of income earned within this state, such amount shall be entered on the return.

(b) If the books are not so kept, but the taxpayer uses a basis of apportionment approved by the Tax Commission, the amount

of net income attributed to this state, as disclosed by the books correctly using such basis, should be entered on the return. If the basis adopted by the taxpayer in making the return does not properly reflect income from sources within this state, the Tax Commission may audit and revise such return by the use of the allocation formula hereinafter referred to.

(c) If the books of the unincorporated business do not disclose the proportion of net income from sources within this state, net income from such sources would ordinarily be determined in accordance with the "alloca-

tion formula" prescribed by law.

(d) If the foregoing methods do not allocate a fair and equitable proportion of the net income of the unincorporated business to the state, such net income will be allocated in a manner prescribed by the Tax Commission.

# Answer to Question 3

The allocation formula is a statutory method for the determination of income from sources within New York State by a comparison of certain "New York State factors" with corresponding total factors. These fac-

tors are as follows:

1. Tangible Property Factor: This is a percentage of the average value of the real and tangible personal property computed at the beginning and end of the taxable year in New York State, divided by the total average value of all real and tangible property, both within and without the State, but only of property connected with the unincorporated business.

2. Wages and Salaries Factor: This is the percentage of salaries, wages and other personal service compensation, paid during the taxable year to employees in connection with the business carried on within New York State, divided by the total wages, salaries and other personal service compensation paid to all employees for services in connection with business carried on both within and without the State.

 Gross Sales Factor: This is the percentage that the gross sales attributed to New York State for the taxable year, bear to all gross sales both within and without

the State.

The above three percentages are averaged and the resulting percentage is used in determining what portion of the total income is subject to the Unincorporated Business

Tax.

It the optometrist maintained separate records for the Connecticut stores and California stores there would be no need for an allocation because in that event, only the New York stores' net income would be subject to the Unincorporated Business Tax.

NATHANIEL FIELD, C.P.A.

# Group VI—Franchise Tax on Real Estate Corporations

Answer to Question 1

The basis for the tax is the actual or full value of the assets on December 31. In many cases, book value has been reduced much below full value. However, assessed value is not necessarily the real value, and successful suits brought to have assessments reviewed by the courts are testimony to that effect. The state frequently accepts current court rulings on writs of certiorari filed in connection with assessments of prior years as a basis for correcting an assessment. If writs are pending, the state has been known to postpone collection of assessments until the courts have ruled. In any event, assessed values may be rebutted, and the facts should be placed before the department as soon as the notices have been received.

Answer to Question 2

A mortgage may be given to stockholders as security for their loans. When this is done, the interest paid to them is not subject to the 2% tax. However, the advantage gained must be compared with the state mortgage tax (\$.50 per \$1000), the federal documentary tax (\$.11 per \$1,000) and recording fees which must be paid when the mortgage is issued. A determining factor is whether the property has been bought for investment or speculation. If the property is not likely to be owned for any length of time, it may be costly to have the mortgage issued. However, the state mortgage tax is deductible as an expense in the year when the mortgage is issued, and that, too, may be a factor. Relative advantages must be weighed in reaching a conclusion.

STANLEY B. TUNICK, C.P.A.



# Committee on Cooperation with Bankers

This committee met jointly with the corresponding committee of the New York Chapter of the Robert Morris Associates on January 11, 1949, at the Harvard Club. Short addresses were made from which the following excerpts were chosen as being of general interest to our readers:

## I-Accounts Receivable

The credit grantor should have a right to assume the following as to the auditor's investigation of accounts receivable unless the auditor, by specific disclaimer, makes such assumptions impossible:

- The auditor has satisfied himself that the amount shown on the balance sheet actually represents the total of outstanding receivables.
- The auditor has satisfied himself that the detailed balances comprising the total arose out of bona fide sales of goods or services constituting the regular business of the company.
- The auditor has satisfied himself that the items comprising the total shown on the statement appear to be good and collectible or that an adequate reserve has been set up to care for uncollectible accounts.
- 4. Those accounts which mature later than one year from the date of the balance

- sheet are shown separately below the current assets, unless trade practice warrants a different treatment or unless it is impracticable to segregate the proportion maturing beyond a year. If it is impracticable to make such segregation, then an explanatory note should be made in connection therewith.
- 5. Accounts receivable from stockholders, directors, officers and employees or affiliated companies, except where they are represented by ordinary and current purchases of merchandise or services are shown separately. If receivables from these sources are of a relatively material amount, they should be shown separately even though they do arise from purchases of merchandise or services.
- Credit balances in the accounts receivable control, if material, have been investigated and are carried under the liabilities on the balance sheet.
- Balances due from creditors have been investigated and are carried under the receivables on the balance sheet.
- An adequate reserve has been provided for doubtful accounts, discounts, allowances, etc. This reserve should be shown on the balance sheet as a deduction from the related asset.
- A proper designation or notation must be made of accounts receivable or any part thereof which have been discounted or assigned as security for loans.

CHARLES A. HOYLER, C.P.A., of Hurdman & Cranstoun, C.P.A's.

# II-The Banker and I.R.C.,

There are a number of ways in which the credit grantor may arrive at, or at least approach, independent judgment as to the existence, and even possibly as to the extent, of Section 102 danger. I bring my remarks to a close by indicating some (but by no means all) of the steps which the bank credit grantor may take to this end. My suggestions are based on study of the applicable statute and the Commissioner's regulations, on analysis of court decisions and, of course, on considerable practical contact with the problem under discussion.

- 1. If I were a bank credit grantor today, I believe I would make it a point specifically to ask a responsible officer of each corporate borrower about its Section 102 status. Past Section 102 trouble frequently means future Section 102 headaches. Assertion of the penalty for one year does not create immunity thereafter,-quite the contrary! In a relatively few situations, it may be found that stockholder-directors have deliberately risked Section 102 penalties because distributions would have subjected them to much heavier tax burdens. In such instances, I would assume that, for credit granting purposes, the penalty would probably be asserted.
- 2. I should like an opportunity to examine the minutes of the corporation for they may throw some light on the borrower's Section 102 problem. Minutes frequently recite reasons for building up surplus, such as plant expansion, modernization and improvements, replacements at higher current costs, growth of re-ceivables, lengthening of credit terms, need for inventory increases, etc. If these asserted needs were not implemented and if the anticipated need of increased working capital was negatived by future operations, then the self-serving declarations may be harmful. The directors of a corporation which has had "bad" banking and/or public financing experiences may determine to build up cash reserves so as to avoid a recurrence of such experiences. Reference to such policy may appear in the minutes. War and post-war conditions may furnish both reason and excuse for delay. Until recently, if, when the decision was reached to retain earnings for future expenditures, adequate surplus was already on hand, even if future earning prospects were good, retention of earn-

- ings would not necessarily be a danger signal. Now, because of pending cases, the answer is in doubt.
- If owners have withdrawn funds from the corporation as personal loans, I would regard this as a danger signal.
- If the corporation has made expenditures for the personal benefit of share-holders, that, too, I would look upon as a danger signal.
- 5. If the corporation has made investments in unrelated enterprises or in those not reasonably connected with its business, that, likewise, I would look upon as a danger signal. Some revenue agents have regarded suspiciously investments in Government bonds, although they were acquired as the result of super salesmanship on the part of Government representatives.
- The use of surplus to enter into a radically different business, as differentiated from expansion within the type of business already engaged in, is a danger signal.
- 7. If amounts representing all or a substantial part of the surplus had been invested in additional plant which appeared to be reasonably needed for the business, or if it had been retained for what I, as a banker, regarded as working capital required by the business, I would not consider the retention as dangerous.
- If earnings were invested in related businesses, either as branches of the existing organization or as corporate subsidiaries, such use of funds would not give me, as a credit grantor, any concern.
- 9. If the corporation has regularly paid dividends which appear to me, as a banker, to be reasonable in terms of the needs of the business, I would regard that as a reassuring fact. Indeed, if I regarded dividend distributions as excessive from the viewpoint of working capital adequacy, I would be tempted to write my customers to such effect, and such communications from bankers could be (and have been) employed advantageously by corporations under attack. If bank loans are needed during some months each year, that is a reassuring Sec. 102 factor.
- 10. If such dividends were usually paid not during the current year but shortly thereafter, soon after the amount of available earnings were ascertained, while I would know that only dividends paid during the current year are deductible in the determination of the net income to which the penalty applies, I would, nevertheless, view such distribu-

tion as an indication that earnings had not been unreasonably retained.

- 11. If dividend payments were restricted because of conditions attached to bank loans, or if earnings were required to be placed in sinking funds for the retirement of obligations in accordance with contractual undertakings, retention of earnings for such purposes is not, of course, a source of concern.
- 12. I should mention, although in this presence it would appear to be unnecessary to do so, that a splendid ratio of current assets to current liabilities, and relatively large net quick assets are danger signals, and that while such conditions may warm the cockles of the heart of the prospective lender, the reverse is true when Section 102 danger is under consideration.
- 13. Finally, I should point out that scrutiny for Section 102 liability must be more intensive when you are dealing with a close corporation than with one which is listed on an exchange or in which there is wide distribution of stockholdings and wherein control is not vested in a few persons.

JOSEPH J. KLEIN, C.P.A., of Klein, Hinds & Finke, C.P.A's.

# III-What the Banker Should Know About Audit Reports

Although theoretically, the auditor examines the *client's* balance sheet and expresses his opinion as to its fairness, the auditor cannot close his eyes to material distortions, on the grounds that the client takes the primary responsibility for the financial statements. Even if a detailed audit is not made, the accountant should be able to justify the reasonableness of each item on the balance sheet.

The Certified Public Accountant has a responsibility to potential credit grantors as well as to his client. The accountant's name on the cover or on the stationery of the report or financial statements indicates some degree of responsibility or endorsement. It is, therefore, important that every financial statement submitted on an account-

ant's stationery indicate the extent of his verification or lack of verification. This qualification may appear in a headnote, in a footnote, or in an accompanying letter.

Bankers are usually desirous of obtaining the auditor's signature. However, it is improper for the auditor to use the words "in my opinion," or "we hereby certify," following a recital that accounts receivable were not confirmed by direct correspondence and the inventory figure was accepted as stated by the management, since these omissions are departures from present generally accepted auditing procedure.

Although the banker prefers that annual reports be completely verified and audited, he must realize that the borrower or client may not have the same desire. The client may want to reduce the cost of the audit; he may not desire to take a detailed, properly supervised inventory; he may not wish to bother his customers or suppliers with verification requests. Obviously, the auditor must be guided by his client's wishes in that respect, and if the banker requires a verified balance sheet before granting a loan or a credit line, he should notify the prospective borrower to that effect before the fiscal year-end in order that proper auditing arrangements may be made. The insistence of all bankers on certified statements once a year from all borrowers, will be welcomed by the accounting profession; but you should realize that this situation does not yet exist.

The banker should also understand that, despite the lack of direct confirmation with outside sources, and the resulting omission of opinion or certificate, the auditor may have by other auditing means generally satisfied himself as to the major balance sheet items.

STEPHEN CHAN, C.P.A., of Eisner & Lubin, C.P.A's.



# The New York Certified Public Accountant

# Book Reviews

(Continued from page 153)

yzes the expense problems it presents, the method by which it can be controlled, and a detailed report of the methods of planning for and installing this type of account. Revolving Credit is the newest type of retail credit accounts and is rapidly being installed in retail stores, both large and small, throughout the country.

The current edition of the Credit Management Year Book will prove an invaluable guide to consultants and accountants and will assist them in advising their clients as to the best and most profitable method of conducting their credit business.

ALBERT S. KLECKNER

Brooklyn, N. Y.

# New Responsibilities of the Accounting Profession

(Papers presented at the Sixty-First Annual Meeting of the American Institute of Accountants; September 19-23, 1948; Chicago, Ill. 128 pages; \$1.50.

The 1948 Papers are grouped into five major categories, viz., (1) Accountants' Reports, (2) Business Costs and Business Income Under Changing Price Levels, (3) Organization and Administration of an Accounting Firm, (4) Accounting Education, and (5) Federal Taxation.

This reviewer found the section (4) on Accounting Education particularly interesting. Included therein are the following papers: A Critique of the Uniform CPA Examination, What Academic Education Should a Prospective Professional Accountant Receive?, In-Service Training of Members of the Staffs of Accounting Firms, What Can a State Society Do to Cooperate with Schools of Business Administration?, Study Groups at the C.P.A. Level, and The Development of a Professional Consciousness.

All of these deal with current, vital problems of the profession.

It is obviously impossible to review adequately all of the many and various topics embraced in this volume in such a brief note as this. Fortunately for those who desire to peruse excellent summaries thereof, sections (1), (2), and (5) are commented upon in the November, 1948, issue of The Journal of Accountancy (pp. 382-388), and sections (3) and (4) in the December, issue (pp. 470-475).

However, the important information gleaned from a thorough study of the complete text will amply reward the conscientious reader.

# Survey of New York Law (1947-1948)

Contained in the November, 1948, issue of the New York University LAW QUARTERLY REVIEW. (Volume XXIII, Number 4.) New York, N. Y.; pp. 537-919, inclusive. Three dollars for this issue; five dollars per year.

This is the second compilation of its kind, presumably embracing all New York statutes, decisions, and material enacted or reported during the fiscal year ended May 31, 1948. It is divided into seven parts:

Part One - Public Law: In General

Part Two — Taxation Part Three — Labor Law

Part Four — Commercial Law

Part Five — Property Law
Part Six — Equity, Torts and Persons

Part Seven - Adjective Law

The chapters on State and Local Taxation, Trusts, and The Law of Succession, as well as the section on Commercial Law should be of interest to practicing accountants.



